SWIFT TRANSPORTATION COMPANY

Moderator: Jason Bates
April 22, 2016
11:00 a.m. ET

Operator: This is conference # 84730126.

Operator: Good morning. My name is (Chris), and I'll be your conference operator today. At this time, I would like to welcome everyone to the Q1 2016 earnings call.

All lines have been placed to prevent any background noise. If you should need operator assistant during the call please press star then zero on your telephone keypad and operator will assist you. Thank you.

Jason Bates, you may begin your conference.

Jason Bates: Great. Thank you, (Chris). We'd like to welcome everyone out to Swift Transportation's first quarter 2016 Q&A session. As a reminder, we have posted a comprehensive letter to stockholders, summarizing our results on the front page of our Investor Relations Web site.

We will start the call today, with our forward-looking statement disclosure. This call contains statements that may constitute forward-looking statements, which are based on information current information currently available. Such forward-looking statements are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995.

Such forward-looking statements are inherently uncertain, are based upon the current beliefs, assumptions, and expectations of Company management, and current market conditions, which are subject to significant risks and uncertainties, as set forth in the risk factors section of our most recently filed annual report Form 10-K.

As a result of these and other factors, actual results may differ from those set forth in the forward-looking statements, and the prices of the Company's securities may fluctuate dramatically. The Company makes no commitment, and disclaims any duty to update or revise any forward-looking statements to reflect future events, new information, or changes in these expectations.

So with that out of the way, I would like to recognize the members of Swift's management team on the line today. We have Jerry Moyes, our Founder and Chief Executive Officer; Richard Stocking, our President and Chief Operating Officer; and Ginnie Henkels, our Executive Vice President and Chief Financial Officer. Again, my name is Jason Bates, Swift's Vice President of Finance, and Investor Relations Officer, and I'll be moderating today's Q&A session.

As part of our evolving IR communication plan, this quarter we strived to streamline on the Q&A process, by addressing key themes and categories, rather than focusing on every single question submitted. We have attempted to address each of the more prevalent topics. However, if you do have follow-up questions, feel free to reach out to me after the call.

So we'll start today's call with some questions on EPS guidance and expectations, followed by a discussion of each of the segments.

Jason Bates: What are the risks and opportunities to your $1.45 to $1.55 adjusted EPS range?

Ginnie Henkels: The opportunities would include a tightening capacity demand equation, which would positively affect utilization and pricing beyond our base assumptions, which Richard will address in a moment. This could result from either an increase in consumer confidence and spending, or due to shipper's shifting freight to ELD-compliant carriers. The primary risk to the current range are continued softness in the freight market, an increase in fuel prices, and any significant claims or adverse development.

Jason Bates: How much of the second half 2016 guidance is predicated on project work rebounding to the level experienced by the Company in 2014 and earlier?

Ginnie Henkels: We're assuming project work to be in line with that which we experienced in 2015, not 2014 and earlier.

Jason Bates: Please clarify insurance claims quote, increase with associated, with current year development, end quote.

Ginnie Henkels: Although our accident frequency is trending favorably, and is down year-over-year, the development of prior year claims negatively impacts the actuarial models that are used to calculate our expense in the current period. This is the effect we are referring to, when we use the term current year development.

Jason Bates: With settlements related to trucking accidents continuing to rise at a rapid pace, is there a risk of more adverse development of prior period claims as the year unfolds, in spite of the Company's improving safety track record?

Ginnie Henkels: Although it is not something we are anticipating, given the long tail associated with claims, it is a possibility.

Jason Bates: What concrete data or observations outside of expectations for ELD-induced tightness give management confidence in its view, that the capacity demand balance will materially improve throughout 2016?

Richard Stocking: Our perspective on the future periods is largely a function of customer interaction and feedback. While macro data points suggest a struggling industrial sector, they also indicate that the consumer is doing OK. As you noted, we have had several customers expressed concerns over shipping with carriers who are not ELD-compliant, or who do not have clear plans to achieve compliance in the near-term. “Materially improve” is relatively strong language, however, we do expect the second half to be better than the first half.

Jason Bates: What would cause ELDs not to be a significant impact on capacity?

Richard Stocking: In our view, unless there is a change to the regulation, there is no reason ELDs would NOT have an impact on industry capacity.

Jason Bates: For clarification, in the $1.45 to $1.55 range, is it correct to assume you are using $0.25 for the first quarter?

Ginnie Henkels: Yes, that is correct.

Jason Bates: Can you discuss quarterly progression of earnings, given the revision in the full-year guidance?

Ginnie Henkels: We would again, point you to the guidance we gave on our fourth quarter earnings call, which we reiterated in more detail on our mid first quarter call. The most recent revision to the full-year guidance would not necessarily affect the anticipated earnings cadence.

Jason Bates: Please clarify what is the base of the $3 million to $5 million increased gain on sale in the second quarter of 2016?

Ginnie Henkels: We actually had several questions, with regard to our gain on sale estimate for the second quarter, and realized we were not very clear in the letter. So to clarify, we are expecting the gain to be a total of $3 million to $5 million for the quarter, which is actually less than we experienced in Q1.

Jason Bates: Is Swift still expecting gains on sales in the $15 million $20 million range for full year 2016, and how should we be thinking about this on a quarterly basis?

Ginnie Henkels: Yes, that is our best estimate at this time. However, as you all know, the used truck market is continually evolving, and could potentially impact that range favorably or unfavorably. We would anticipate the gains to be in the range of $3 million to $5 million each quarter.

Jason Bates: Do have an estimated breakdown of where the 200 tractors will be removed from the segments?

Ginnie Henkels: It will be a little bit from each of the segments, where ever we have the opportunity to improve utilization.

Jason Bates: Does the new guidance range reflect adjusted expectations for contract rates during the rest of the year?

Ginnie Henkels: Yes, that has been factored into the revised guidance range.

Jason Bates: We're going to move into the truckload segment questions. The first, what is driving the rate pressure across the truckload industry? Do customers have serious doubts about capacity tightening, as a result of the forthcoming capacity-constraining regulations?

Richard Stocking: It is a combination of activities. There are brokers in the market trying to capture share, there has been freight softness in the market creating excess capacity. And there are some carriers in the market exhibiting irrational behavior, in an attempt to keep equipment, as well as drivers moving. Customers are concerned about future capacity, but some are taking advantage of these short-term dynamics leading to lower pricing. However, we believe this trend is not sustainable in the long-term.

Jason Bates: Will the tremendous rate pressure in the spot market drive more small carriers out of business, before they have to worry about ELD speed limiters, sleep apnea testing, et cetera?

Jerry Moyes: As we've stated in the past, we believe that the recently discussed behavior is not healthy for the market, and will lead to an increase in bankruptcies among smaller carriers in our industry. This will obviously have an effect on capacity, availability which should favor -- have a favorable impact on companies like Swift.

Jason Bates: How would management describe the pricing environment out there? Is the 0.7 percent revenue per loaded mile ex-fuel surcharge in first quarter sustainable?

What does management expect for revenue per loaded mile ex FS for the current year?

Richard Stocking: Given the current market dynamics previously discussed, we believe full-year revenue per loaded mile could be up to 2 percent, as opposed to the previously anticipated 2 percent to 3 percent. However, we do believe that rates will strengthen on a year-over-year basis in the back half of 2016. Keep in mind, in Q1, we held some broker business, as well as some intermodal business at lower paying rates in our truckload division that affected our overall revenue per loaded mile.

Jason Bates: What are your customers telling you about the much-advertised inventory glut that is supposedly currently depressing demand for truckload services?

Richard Stocking: There are a lot of different thoughts within the industry on this topic. We believe the current inventory cycle has been a slight headwind on freight volumes. There are shippers out there that are reducing their safety stock, and becoming a more just-in-time shipper. However, this will ultimately be a positive for carriers. Additionally, we have a variety of customers who are opportunistic and buying inventory right now, and will warehouse this inventory affecting the reported inventory data points.

Jason Bates: How many bids are still outstanding at this point of the current cycle?

Richard Stocking: Although, the first quarter was a bit stronger than normal this year, as we have discussed on past calls, our book of business is pretty -- or is priced pretty evenly throughout the year.

Jason Bates: How much business is Swift winning in bids, where carriers are kicked out without an ELD?

Richard Stocking: It is increasing in regularity, and we expect this dynamic today momentum in the back half of this year, and more so into 2017 and 2018. We have already realized several million dollars of business awards due to shipper's expectations of carriers to have an ELD implementation plan.

Jason Bates: How does April truckload demand look? What has been the biggest disappointment, capacity or retail inventory overhang?

Jerry Moyes: As you've heard from some of our peers, April has been sluggish so far. It's been a combination of capacity and the inventory, as was previously discussed. We do, however, believe we're going to gain momentum as the quarter unfolds. I've been out on the road, most of the last couple of weeks, and I can tell you two things. Number one, we picked up some very good business, and number two, most of our customers are very positive about third and fourth quarter.

Jason Bates: Has management's target of a 1 percent increase in truckload utilization changed, in light of the current environment, and the Company's decision to modestly shrink the fleet?

Richard Stocking: It has not changed. Our entire organization is focused on improving utilization. We remain committed to managing our fleet size to the freight volumes, to drive success in achieving progress in this most important initiative.

Jason Bates: Has driver turnover increased, given the market challenges, and the reduction in loaded miles per tractor within truckload?

Richard Stocking: Our retention figures are very respectable, and some of the best in our Company's history. We are extremely proud of the numerous driver-friendly initiatives we have implemented over the years, which we continue to develop.

Jason Bates: Moving to the dedicated segment. Was the solid pricing gain at dedicated, the result of contract renegotiations, or did Swift add new business in the quarter that allowed it to gain solid pricing?

Please talk about some of the productivity measures that led to the strong productivity gains, and solid operating ratio performance in the quarter?

Richard Stocking: The year-over-year revenue per truck gain was due to a variety of operational improvements, such as increasingly -- or increasing our weekly loaded miles per truck, our pricing, rate increases, generating more backhaul revenue, while also hyper-focusing on underperforming fleets. Although we are proud of the progress we've made, we remain committed to continued improvements. We are happy with the team we have in place, and we look forward to positive results in the future.

Jason Bates: Can you give more detail on your progress in getting through profitable dedicated accounts? And the quote, specific opportunities for continued growth, end quote, you mentioned in the first quarter fourth quarter earnings call?

Richard Stocking: We continue to have a disciplined and methodical focus on finding opportunities to reduce operating costs. In the first quarter, we were able to shed several underperforming fleets, while improving the profitability of other fleets, through maximizing the productivity of our resources, i.e. removing unmanned trucks like we talked about, increasing backhaul revenue, reducing trader [pools], et cetera. The growth environment in the first quarter was difficult due to available over the road capacity, and private fleets keeping their owned fleets busy. We had a number of dedicated bids, where ultimately the incumbent was retained. However, we do foresee growth opportunities here, on the horizon.

Jason Bates: Moving to the intermodal segment, how integral is intermodal to your overall strategy?

Richard Stocking: Similar to what we have reiterated on prior calls, we believe intermodal can offer long-term value to both Swift's customers and shareholders. Many of our current customers value a true asset-based multimodal transportation solution, of which Swift is one of only a few companies that can truly offer this value to other customers.

That being said, intermodal like every other business at Swift, must cover its cost of capital. If we feel the intermodal division is not likely to attain this objective, we evaluate all options available to us.

We still believe we can reach a mid-90 percent operating ratio on a consistent basis. And that remains our main objective, to continue to work with our real partners, in order to reduce our real costs. And we are focused on growing top line revenue, while implementing cost control initiatives.

The first quarter was a challenge, from a volume perspective. However, we do believe we do not believe we are entering a long-term market turndown. As inventory levels are reduced, and customers better understand the impact of upcoming ELD requirements, we anticipate a gradual strengthening of demand, as we move further into this year. We feel our operating model is refined, our service and safety results are strong, we have taken costs out of the intermodal division. The foundational components to deliver consistent profitability are in place, as we bring in more profitably priced volumes.

Jason Bates: Have rail service issues from flooding impacted first quarter operations?

Jerry Moyes: Intermodal service has been very good for the first quarter, with a few exceptions caused by the flooding in the southern US. There are some lanes which could still be improved, but however, at a broad level, the rail service is back to their previous high levels.

Jason Bates: Is the competitive pricing in intermodal being driven by multiple players, or are you seeing one large competitor sway the market?

Jerry Moyes: The current market can be characterized by inconsistent demand. One competitor, in particular, has focused on volume growth, at the expense of price. The reduced fuel prices, combined with adequate truckload capacity has created pressure on the intermodal volumes, particularly in shorter length of haul.

Notwithstanding this situation though, many shippers remain committed to intermodal, as rail service results have been strong. And they have a concern on whether, there is adequate truckload capacity to support their business needs, in both in immediate and long-term future.

Jason Bates: Can you discuss the intermodal initiatives, more color on what these are, potential savings, et cetera?

Richard Stocking: Sure. Some of our key intermodal initiatives include increasing our volumes with adequately priced freight, improving the terms of our container fleets to desired levels, and additional fixed and variable cost reduction, including reducing non-driver headcount. We also feel that is an opportunity to improve efficiencies in our dray operations. And we do this by focusing upon increasing truck utilization through increase slip seating, reduced dray trucks in selected markets, and relocated intermodal operating points closer to the rail ramps. Additionally, we are reducing our chassis rental costs through a tactical stacking of containers. All of these things, are happening as we speak. We, like our investors, feel the urgency, as it relates to improving this line of business.

Jason Bates: That takes us to the Swift Refrigerated segment. It seems like the progress at Central Refrigerated have not met expectations thus far. What the plans to turn things around in this segment?

Richard Stocking: Yes, there are a lot of positive things happening at Swift Refrigerated, however, we have experienced some headwinds along the way, which we have -- which have impediments to achieving our desired financial performance. Having said that, we are currently encouraged by recent improvements in our safety and claims, accident frequency, and cargo claims are trending in the right direction. Driver retention has improved significantly over the recent quarters, and their deadhead and utilization improved year-over-year in the first quarter by 20 basis points, and 4.2 percent, respectively.

So while recent headwinds and customer turnover have clearly impacted financial results, the team is diligently working to pull the levers at its disposal, while seeking to profitably replace lost business. The turnaround will not be immediate, but we are optimistic about the long-term position potential of this business, through our overall suite of services.

Jason Bates: Is any danger of losing additional temperature-controlled business to the spot market, given the enticing price points available currently in that market?

Richard Stocking: The vast majority of our customers are long-term focused, and continue to seek quality carriers who can haul their freight safely and on time. Although the current spot market maybe enticing, based on feedback we are receiving, we don't anticipate losing substantial business to the spot market.

Jason Bates: Has the more concerted push by railroads into temperature-controlled containers affected your business results or the outlook?

Richard Stocking: No, this hasn't had a significant impact on our business.

Jason Bates: Is the oncoming freight from new customers within Swift Refrigerated going to represent a similar revenue per mile profile, than that of the freight from the two large customers that was lost?

Richard Stocking: This is good news. We are very excited about the new business that is ramping up during the second quarter, as it brings with it a solid rate per loaded mile and higher utilization. Based on these two factors, and the expected volume of this award, with great customers, we expect the weekly revenue per truck for the segment to increase from the baseline established during the first quarter.

Jason Bates: How quickly can refrigerated bounce back with new, more profitable business?

Richard Stocking: We have been able to replace most of the business that was lost in the early part of the quarter, and feel that the market will continue to improve, and produce more favorable conditions into the second quarter. As we move into the produce and fresh season, we expect the market conditions to gain momentum. With improving market conditions and new awards starting in May, we anticipate better results in the second quarter, and throughout the remainder of 2016. We have had success with servicing our customers, evidenced by our recent Carrier of the Year awards, and our -- and we believe this will translate into new freight awards and price increases.

Jason Bates: Were the lost refrigerated customers related, or completely separate?

Jerry Moyes: No, the two customers were unrelated.

Jason Bates: We're going to move to some questions about debt and CapEx, as well as a few miscellaneous questions. You had significant free cash flow in the quarter. Will you use all of this to repurchase shares in Q2? What are your share repurchase assumptions for the year?

Ginnie Henkels: As we discussed previously, our share repurchases are contingent upon our free cash flow expectations for the year after fleet replenishment, and at least $30 million to $50 million of debt reduction. Our free cash flow in the first quarter was approximately $130 million, with which we reduced our debt by $50 million, and repurchased $45 million of shares. Our net cash capital expenditures netted to zero, after considering the proceeds from the sale of equipment. This was lower than originally anticipated, due to the delay on certain tractor purchases to right-size the fleet to current demand, as we discussed in the letter. The end result was an increase in our cash balance of $35 million, which also helped to lower our leverage ratio to 1.89, since is this is calculated based on debt net of cash. That is a very long-winded way of saying, that our free cash flow was unusually high in the first quarter. For the full-year, our net cash CapEx should be toward the lower end of the $200 million to $250 million range for the full-year, given the pullback in the first quarter. Therefore, with an increase in CapEx in the next three quarters compared to Q1, I would expect our free cash flow, and the pace of repurchases to slow somewhat over the next two quarters, given normal seasonality and free cash flow. Our net debt balance and leverage ratio may fluctuate a bit, but both should remain below December 31 balances.

Jason Bates: Does the market outlook in any way impact your approach to repurchasing shares over the next several quarters, or primarily just price sensitivity?

Ginnie Henkels: The market outlook could impact our repurchasing, as purchases are based on our outlook for free cash flow, which would be impacted by changes in the market. Price sensitivity is also a factor.

Jason Bates: Has the M&A market in the truckload sector been helped or hurt by volatility in the valuations, and the increased level of competitive intensity in the marketplace?

Ginnie Henkels: It's a bit difficult to comment on this, as we have not been active in M&A, and are not aware of any significant transactions that have occurred as of late.

Jason Bates: How would you characterize the driver market currently? Are you satisfied with the general quality of your recruits? Have the pay increases helped stabilize your workforce?

Richard Stocking: The driver market continues to be challenging. The pay increases have definitely helped, and have bolstered our recruiting efforts. Our schools continue to be full, and we have had a steady pipeline of new recruits. Our retention levels are good, and remain well below the industry average, but we feel we can continue to improve in this area. The weakness in the freight market is a frustration for drivers, as it reduces our utilization, and the miles the drivers are driving. Therefore, their paychecks are impacted negatively, partially offsetting the benefit of the pay increases. This is one of the reasons we have reduced the fleet. We want to ensure, we are getting as many miles as possible, to keep our current drivers, and to keep them happy.

Jason Bates: What safety technologies are you evaluating for installation on your trucks? What are the cost-benefit ratios associated with these investments?

Jerry Moyes: We are investing in collision-avoidance systems, lane departure and automatic transmissions and event recorders, and other technologies to improve the safety of our equipment. Based on the strong results, that we have been experienced thus far with this new technology, we believe that return on investment will be achieved.

Jason Bates: Will the tightening insurance market increase your premium costs for the layer of coverage in excess of $10 million per occurrence?

Ginnie Henkels: The (destruction) in the insurance market is occurring in the primary coverage levels, for which we are self-insured. Our premiums for our excess liability insurance above our $10 million self-insured retention level is a small portion of our overall insurance and claims line. With that said, we are in the middle of a multi-year program, so we do not expect to have a significant impact in the near-term. With the investments we have been making, with the safety enhancements to the equipment, and the improvements in our frequency and severity trends, we hope to mitigate the impact of a tightening market when our renewal occurs.

Jason Bates: Do you believe that you will need to do anymore driver wage increases this year?

Jerry Moyes: Given the current environment, we do not anticipate giving any additional across-the-board increase, rate increases. Our goal is to increase the driver's W-2 by increasing his utilization, and the number of miles that they can drive.

Jason Bates: Can you discuss some of the impacts, measures, or occurrences in the quarter that led to the lower tax rate? How should we be thinking about tax rate in the remaining quarters, given these results?

Ginnie Henkels: As we discussed in the letter, the tax benefits received in the quarter were related to reductions in reserves for uncertain tax positions, related to certain states, as well as certain income tax credits realized by our Mexican subsidiary. Based on this, and on other items, we do expect our effective tax rate to be lower for the remainder of the year, and should be approximately 37.5 percent in each of the next three quarters.

Jason Bates: Can you give some color on what drove the $4.4 million in losses in your other segment, and whether or not this is expected to continue?

Ginnie Henkels: The $4.4 million loss was driven by the amortization of intangibles, and certain unallocated corporate expenses. The difference year-over-year was driven by a change in allocation methodology that occurred last year in Q2, therefore, we would expect the trend going forward, to be similar to the trend we had last year.

Jason Bates: Great. Thank you. That concludes the questions we received. We're going to go ahead, and turn it over to Jerry for a summary.

Jerry Moyes: In summary, as you have heard from our peers and us, the first quarter was one of the most difficult, challenging markets we have experienced in some time. However, in spite of industry headwinds, we did generate $0.25 of earnings per share. We are optimistic about our recent freight awards which will assist us in our organization-wide focus on enhancing the utilization of our fleets in each of our service offerings. Additionally, the entire organization remains extremely focused and disciplined on managing our controllable costs. We will continue to pull all the levers we have at our disposal to generate utilization improvement, drive out cost, and streamline our processes. The combination of these activities will help further drive profitability improvements.

I've spent most of the last two weeks meeting with the customers, and I can tell you, that almost every one of them are very concerned about the upcoming ELD mandates, and its potential impact on the industry. We believe this will have a tightening effect on capacity, on demand equation in the back half of this year, and more so in 2017. With that, and we appreciate the continued support of Swift. I'm looking forward to talking with you on our mid quarter call. Thank you very much.

Operator: Ladies and gentlemen, this concludes today's conference call. You may now disconnect.

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