

KNIGHT TRANSPORTATION INC  
Form 10-Q  
November 08, 2005

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2005

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-24946

**KNIGHT TRANSPORTATION, INC.**  
(Exact name of registrant as specified in its charter)

**Arizona**  
(State or other jurisdiction of  
incorporation or organization)

**86-0649974**  
(I.R.S. Employer  
Identification No.)

**5601 West Buckeye Road  
Phoenix, Arizona  
85043**  
(Address of Principal Executive Offices)  
(Zip Code)

Registrant's telephone number, including area code: **602-269-2000**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ Yes ☐ No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). ☒ Yes ☐ No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ☐ Yes ☒ No

The number of shares outstanding of registrant's Common Stock, par value \$0.01 per share, as of October 21, 2005 was 56,949,187 shares.

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Table of Contents**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements**

**KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Balance Sheets (unaudited)**  
**As of September 30, 2005 and December 31, 2004**  
**(In thousands)**

	September 30, 2005	December 31, 2004
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 5,835	\$ 23,155
Short-term investments	20,782	2,202
Accounts receivable, net	72,499	58,733
Notes receivable, net	240	171
Inventories and supplies	3,138	2,332
Prepaid expenses	6,318	5,215
Income tax receivable	—	3,216
Restricted cash	6,805	—
Deferred tax asset	8,123	7,493
<b>Total current assets</b>	<b>123,740</b>	<b>102,517</b>
<b>PROPERTY AND EQUIPMENT:</b>		
Land and improvements	18,163	16,516
Buildings and improvements	32,378	26,944
Furniture and fixtures	7,037	6,610
Shop and service equipment	2,758	2,739
Revenue equipment	400,834	338,413
Leasehold improvements	806	833
	461,975	392,055
Less: Accumulated depreciation and amortization	(130,974)	(104,125)
<b>PROPERTY AND EQUIPMENT, net</b>	<b>331,001</b>	<b>287,930</b>
<b>NOTES RECEIVABLE - long-term</b>	<b>276</b>	<b>77</b>
<b>GOODWILL</b>	<b>8,119</b>	<b>7,504</b>
<b>OTHER ASSETS</b>	<b>2,119</b>	<b>4,839</b>
	<b>\$ 465,255</b>	<b>\$ 402,867</b>

The accompanying notes are an integral part of these condensed consolidated financial statements.



Table of Contents**KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES****Condensed Consolidated Balance Sheets (unaudited) (continued)****As of September 30, 2005 and December 31, 2004****(In thousands, except par values)**

	September 30, 2005	December 31, 2004
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 10,055	\$ 5,044
Accrued payroll	5,192	4,558
Accrued liabilities	7,840	5,684
Income taxes payable	2,434	-
Claims accrual	23,615	23,904
Other current liabilities	6,555	—
Dividend payable	1,138	—
Total current liabilities	56,829	39,190
OTHER LIABILITIES	250	-
DEFERRED INCOME TAXES	74,510	72,660
Total liabilities	131,589	111,850
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred stock, \$0.01 par value; authorized 50,000 shares; none issued and outstanding	—	—
Common stock, \$0.01 par value; authorized 100,000 shares; 56,914 and 56,665 issued and outstanding at September 30, 2005 and December 31, 2004, respectively	569	567
Additional paid-in capital	85,010	82,117
Retained earnings	248,087	208,333
Total shareholders' equity	333,666	291,017
	\$ 465,255	\$ 402,867

The accompanying notes are an integral part of these condensed consolidated financial statements.



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**KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Income (unaudited)**  
**(In thousands, except per share data)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
<b>REVENUE</b>				
Revenue, before fuel surcharge	\$ 127,444	\$ 106,109	\$ 358,241	\$ 296,521
Fuel surcharge	18,744	7,947	43,996	18,996
Total revenue	146,188	114,056	402,237	315,517
<b>OPERATING EXPENSES:</b>				
Salaries, wages and benefits	41,934	34,441	118,047	96,904
Fuel	37,051	21,879	93,084	59,011
Operations and maintenance	9,067	7,234	24,869	19,022
Insurance and claims	4,916	5,376	17,221	15,978
Operating taxes and licenses	3,112	2,476	9,006	7,066
Communications	1,009	912	2,936	2,653
Depreciation and amortization	13,328	10,463	38,423	28,935
Lease expense - revenue equipment	67	634	67	2,903
Purchased transportation	8,585	7,560	22,196	21,697
Gain on sales of equipment	(464)	—	(1,783)	—
Miscellaneous operating expenses	2,571	2,305	7,198	6,253
	121,176	93,280	331,264	260,422
Income from operations	25,012	20,776	70,973	55,095
Interest and investment income	188	132	442	339
Other income	551	—	551	—
	739	132	993	339
Income before taxes	25,751	20,908	71,966	55,434
INCOME TAXES	(10,300)	(8,350)	(28,800)	(22,150)
Net income	\$ 15,451	\$ 12,558	\$ 43,166	\$ 33,284
<b>Earnings per common share and common share equivalent:</b>				
Basic	\$ 0.27	\$ 0.22	\$ 0.76	\$ 0.59
Diluted	\$ 0.27	\$ 0.22	\$ 0.75	\$ 0.58
<b>Weighted average number of common shares and common share equivalents outstanding:</b>				
Basic	56,865	56,402	56,810	56,332
Diluted	57,829	57,747	57,810	57,534

The accompanying notes are an integral part of these condensed consolidated financial statements.

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**KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Cash Flows (unaudited)**  
**(In thousands)**

	Nine Months Ended September 30,	
	2005	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 43,166	\$ 33,284
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	38,423	28,935
Gain on sales of equipment	(1,783)	—
Gain on sale of investment in Concentrek, Inc.	(551)	—
Non-cash compensation expense for issuance of stock to certain member of board of directors	35	13
Provision for allowance for doubtful accounts	(174)	(276)
Tax benefit on stock option exercises	1,198	686
Deferred income taxes	(385)	8,080
Changes in assets and liabilities:		
Change in short-term investments	(18,580)	—
Increase in trade receivables	(10,333)	(13,828)
Increase in inventories and supplies	(806)	(621)
(Increase) decrease in prepaid expenses	(924)	5,164
Decrease in income tax receivable	3,216	1,761
Increase in other assets	(913)	(930)
(Decrease) increase in accounts payable	(412)	3,359
Increase in accrued liabilities, claims accrual and other	11,140	9,093
Net cash provided by operating activities	62,317	74,720
<b>CASH FLOW FROM INVESTING ACTIVITIES:</b>		
Purchase of property and equipment	(73,665)	(92,650)
Proceeds from sales of equipment	7,617	—
(Increase) decrease in notes receivable	(253)	624
Acquisition activity	(3,284)	—
Restricted cash received	(6,805)	—
Proceeds from sale of investment in Knight Flight Services	1,388	—
Proceeds from sale of investment in Concentrek, Inc.	2,795	—
Net cash used in investing activities	(72,207)	(92,026)

The accompanying notes are an integral part of these condensed consolidated financial statements.

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**KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Cash Flows (unaudited) (continued)**  
**(In thousands)**

	Nine Months Ended September 30,	
	2005	2004
<b>CASH FLOW FROM FINANCING ACTIVITIES:</b>		
Dividend paid	(2,273)	—
Payment of notes payable acquired	(6,819)	—
Proceeds from exercise of stock options	1,662	1,138
Net cash (used in) provided by financing activities	(7,430)	1,138
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(17,320)</b>	<b>(16,168)</b>
CASH AND CASH EQUIVALENTS, Beginning of period	23,155	40,550
CASH AND CASH EQUIVALENTS, end of period	\$ 5,835	\$ 24,382
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Noncash investing and financing transactions:		
Equipment acquired in accounts payable	\$ 4,938	\$ 6,966
Net book value of equipment traded	—	8,854
Cash Flow Information:	\$ 21,981	\$ 10,308
Income taxes paid		

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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**KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**Note 1. Financial Information**

The accompanying condensed consolidated financial statements include the accounts of Knight Transportation, Inc., and its wholly owned subsidiaries (the "Company"). All material inter-company balances and transactions have been eliminated in consolidation.

The condensed consolidated financial statements included herein have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures have been omitted or condensed pursuant to such rules and regulations. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Results of operations in interim periods are not necessarily indicative of results for a full year. These condensed consolidated financial statements and notes thereto should be read in conjunction with the Company's consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004.

Cash and cash equivalents is comprised of short-term highly liquid instruments with insignificant interest rate risk and original maturities of three months or less. Auction-rate securities are securities with an underlying component of a long-term debt or an equity instrument. Auction-rate securities trade or mature on a shorter term than the underlying instrument based on an auction bid that resets the interest rate of the security. The Company had previously classified its auction-rate securities as cash equivalents based on the period from the purchase to the first reset date. The Company has reclassified \$2.2 million of auction-rate securities from cash equivalents to short-term investments as of December 31, 2004.

Short-term investments is comprised of trading marketable debt securities with original maturities of greater than three months and represent an investment of cash that is available for current operations. These investments are recorded at fair value with realized and unrealized gains and losses included in interest income on the attached condensed consolidated financial statements.

**Note 2. Stock-Based Compensation**

Stock-Based Compensation - At September 30, 2005, the Company had one stock-based employee compensation plan. The Company applies the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations, including Financial Accounting Standards Board (FASB) Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25," issued in March 2000, to account for its fixed-plan stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. No stock-based employee compensation cost is reflected in net income, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS No. 123. The following table illustrates the effect on net income if the fair-value-based method

had been applied to all outstanding and unvested awards for the three-month and nine-month periods ended September 30, 2005 and 2004, respectively (in thousands, except per share data):

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income, as reported	\$ 15,451	\$ 12,558	\$ 43,166	\$ 33,284
Deduct total stock-based compensation expense determined under fair-value based method for all awards, net of tax	(533)	(254)	(1,600)	(761)
Pro forma net income	\$ 14,918	\$ 12,304	\$ 41,566	\$ 32,523
Basic earnings per share:				
As reported	\$ 0.27	\$ 0.22	\$ 0.76	\$ 0.59
Pro forma	\$ 0.26	\$ 0.22	\$ 0.73	\$ 0.58
Diluted earnings per share:				
As reported	\$ 0.27	\$ 0.22	\$ 0.75	\$ 0.58
Pro forma	\$ 0.26	\$ 0.21	\$ 0.72	\$ 0.57

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 2005: risk free interest rate of 4.0%; expected life of 6.0 years; expected volatility of 48%; expected dividend yield rate of 0.3%; and expected forfeitures of 3.78%. The following weighted average assumptions were used for grants in 2004: risk free interest rate of 4.0%; expected life of 6.5 years; expected volatility of 49%; expected dividend yield rate of zero; and expected forfeitures of 3.68%.



Table of Contents**Note 3. Earnings Per Share (in thousands, except per share data)**

A reconciliation of the basic and diluted income per share computations for the three months and nine months ended September 30, 2005 and 2004, respectively, is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Weighted average common shares outstanding - basic	56,865	56,402	56,810	56,332
Effect of stock options	964	1,345	1,000	1,202
Weighted average common shares and common share equivalents outstanding - diluted	57,829	57,747	57,810	57,534
Net income	\$ 15,451	\$ 12,558	\$ 43,166	\$ 33,284
Earnings per common share and common share equivalent				
Basic	\$ 0.27	\$ 0.22	\$ 0.76	\$ 0.59
Diluted	\$ 0.27	\$ 0.22	\$ 0.75	\$ 0.58

Options to purchase shares of common stock that were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares, and, therefore, the effect would be antidilutive, were not material at September 30, 2005 and 2004.

**Note 4. Segment Information**

Although the Company has many service centers, it has determined that it has one reportable segment. All of the centers are managed based on regions in the United States in which the Company operates. Each of these service centers has similar economic characteristics as they all provide short to medium-haul truckload carrier services of general commodities to a similar class of customers. In addition, each service center exhibits similar financial performance, including average revenue per mile and operating ratio. As a result, the Company has determined that it is appropriate to aggregate its service centers into one reportable segment consistent with the guidance in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information". Accordingly, the Company has not presented separate financial information for each of its service centers. The Company anticipates that in the future the recently initiated brokerage subsidiary will qualify as a segment; currently, however, the results of that operation are relatively immaterial.

**Note 5. Derivative Instruments**

All derivatives are recognized on the balance sheet at their fair value. On the date the derivative contract is entered into, the Company designates the derivative as either a hedge of the fair value of a recognized asset or liability or of a firm commitment ("fair value" hedge), a hedge of a forecasted transaction or the variability of cash flows to be received

or paid related to a recognized asset or liability (“cash flow” hedge), a foreign-currency fair-value or cash-flow hedge (“foreign currency” hedge), or a hedge of a net investment in a foreign operation. The Company formally assesses, both at the hedge’s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. When it is determined that a derivative is not effective as a hedge or that it has ceased to be an effective hedge, the Company discontinues hedge accounting prospectively.

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The Company is party to a contract relating to the price of heating oil on the New York Mercantile Exchange (“NYMX”) that was entered into in February 2002 in connection with volume diesel fuel purchases. If the price of heating oil on the NYMX were to fall below \$0.58 per gallon, the Company may be required to pay the difference between \$0.58 and the index price for 750,000 gallons per month for the remaining three months of 2005.

**Note 6. New Accounting Pronouncements**

In December 2004, the FASB issued SFAS No. 123 (revised 2004), “Share-Based Payment”. SFAS No. 123 (revised 2004) is a revision of FASB Statement No. 123, “Accounting for Stock-Based Compensation”. This statement supersedes APB Opinion No. 25, “Accounting for Stock Issued to Employees”, and its related implementation guidance. SFAS No. 123 (revised 2004) requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award. This statement is effective for the Company on January 1, 2006, and the Company is in the process of evaluating the complete impact of SFAS No. 123 (revised 2004) on its consolidated financial statements.

**Note 7. Commitments and Contingencies**

The Company is involved in certain legal proceedings arising in the normal course of business. In the opinion of management, the Company’s potential exposure under any currently pending or threatened legal proceedings will not have a material adverse effect upon the Company’s financial position or results of operations.

**Note 8. Stock Split**

On July 20, 2004, the Company effected a 3-for-2 stock split. Earnings per share for all periods presented have been adjusted to reflect the stock split.

**Note 9. Dividend**

In September 2005, the Company declared a cash dividend of \$.02 per share on its common stock. The dividend was payable to shareholders of record on September 30, 2005, and was paid on October 18, 2005. This was the third quarterly dividend for 2005. The Company currently expects to continue to pay quarterly cash dividends in the future. Future payment of cash dividends, and the amount of any such dividends, will depend upon financial condition, results of operations, cash requirements, tax treatment, and certain corporate law requirements, as well as other factors deemed relevant by the Company's Board of Directors.

**Note 10. Other Assets**

In June 2005, the Company sold its 19% interest in Knight Flight Services, LLC (“Knight Flight”) which purchased and operates a Cessna Citation 560 XL jet aircraft. The Company sold this investment for its current carrying value of \$1.4 million.

In September 2005, the Company sold its entire ownership interest in Concentrek, Inc. The Company owned a 17% interest in Concentrek, Inc., which is a logistics company based in Jenison, Michigan. The Company received \$2.8 million in initial proceeds from the sale. These proceeds also satisfied all outstanding loans that the Company had with Concentrek, Inc., and resulted in a net gain on the transaction of \$550,702. This gain amount is reflected in other income on the accompanying consolidated financial statements. In addition to the proceeds received in September 2005, the Company has potential to participate in a portion of a future earn-out as provided in the sale agreement. Terms of that earn-out are contingent upon Concentrek, Inc. maintaining or achieving specified earnings levels in

future periods. Upon future resolution, when an earn-out becomes distributable, the Company will recognize any additional gains. The Company also received \$6.8 million of restricted cash in September 2005 on behalf of others participating in this transaction. This cash was distributed to these other parties subsequent to September 30, 2005.

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### **Note 11. Acquisition**

On August 12, 2005, the Company acquired 100% of the stock of Edwards Brothers, Inc. ("EB"), an Idaho based temperature controlled truckload carrier. The acquisition included 140 tractors and 224 trailers. The total purchase price has been allocated to tangible and intangible assets acquired and liabilities assumed based on their fair market values as of the acquisition date in accordance with Financial Accounting Standards Board statement number 141 (SFAS No. 141), "Business Combinations". Goodwill has been recorded on the balance sheet for the amount which the purchase price exceeded the fair value of the assets and liabilities acquired. The acquisition has been accounted for in the Company's results of operations since the acquisition date. The pro forma effect of the acquisition on the Company's results of operations is immaterial. In addition to the purchase price, the purchase agreement sets forth certain conditions upon which an earn-out adjustment to the purchase price may be needed. Any adjustment for this potential earn-out is not expected to be material.

### **Note 12. Related Party Transaction**

In September 2005, the Company purchased land and a building from a member of its Board of Directors at fair value for a total purchase price of \$4.5 million. The facility purchased is located in Phoenix, Arizona and contains the Company's corporate headquarters, along with several operating divisions. Prior to this purchase, the Company had been leasing this facility from this board member since the Company's inception in 1989. This facility also has additional space which is under long-term rental agreements with unrelated parties. These lease agreements have been assigned to the Company as part of the purchase agreement. The Company will receive monthly rental income for this additional space of approximately \$22,000 per month.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Cautionary Note Regarding Forward-Looking Statements**

*Except for certain historical information contained herein, the following discussion contains "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Section 27A of the Securities Act of 1933, as amended, that involve risks, assumptions, and uncertainties which are difficult to predict. All statements, other than statements of historical fact, are statements that could be deemed forward-looking statements, including without limitation: any projections of earnings, revenues, or other financial items; any statement of plans, strategies, and objectives of management for future operations; any statements concerning proposed new services or developments; any statements regarding future economic conditions or performance; and any statements of belief and any statement of assumptions underlying any of the foregoing. Words such as "believe," "may," "will," "could," "should," "likely," "expects," "estimates," "anticipates," "projects," "plans," "intends," "hopes," "potential," "continue," and "future" and variations of these words, or similar expressions, are intended to identify such forward-looking statements. Actual events or results could differ materially from those discussed in forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Factors That May Affect Future Results," set forth below. We do not assume, and specifically disclaim, any obligation to update any forward-looking statement contained in this report.*

### **Introduction**

#### **Business Overview**

We are a truckload carrier based in Phoenix, Arizona. We transport general commodities for shippers throughout the United States, generally focusing our operations on short-to-medium lengths of haul. We provide regional truckload

carrier services from our 20 regional dry van service centers located throughout the United States, and we also provide temperature controlled service through our subsidiaries located in Phoenix, Arizona and Idaho Falls, Idaho. In July 2005, we initiated a brokerage subsidiary. We view brokerage as a natural extension of our customer offerings and look forward to providing a non-asset based capability to service our customers' freight when the shipments do not fit our asset-based model, or when all of our available internal capacity in the desired area has been allocated to other shipments. Over the past five years we have achieved substantial revenue and income growth as a result of our continuing expansion into new regional markets, emphasis on maintaining and improving efficiencies and cost control discipline, and success at obtaining rate increases as a result of providing a high level of customer service. During this period, our revenue, before fuel surcharge, grew at a 19% compounded annual rate from \$207.4 million in 2000 to \$411.7 million in 2004, and our net income grew at a 28% compounded annual rate from \$17.7 million in 2000 to \$47.9 million in 2004.

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### ***Operating and Growth Strategy***

Our operating strategy is focused on the following core elements:

- *Focusing on Regional Operations.* We seek to operate primarily in high-density, predictable traffic lanes in selected geographic regions. We believe our regional operations allow us to obtain greater freight volumes and higher revenue per mile, and also enhance safety and driver recruitment and retention.
- *Maintaining Operating Efficiencies and Controlling Costs.* We primarily focus on operating in distinct geographic and shipping markets in order to achieve increased penetration of targeted service areas and higher equipment utilization in dense traffic lanes. We actively seek to control costs by, among other things, operating a modern equipment fleet, maintaining a high tractor to non-driver employee ratio, and regulating vehicle speed.
- *Providing a High Level of Customer Service.* We seek to compete on the basis of service in addition to price, and offer our customers a broad range of services to meet their specific needs, including multiple pick ups and deliveries, on-time pick ups and deliveries within narrow time frames, dedicated fleet and personnel, and specialized driver training.
- *Using Technology to Enhance Our Business.* Our tractors are equipped with satellite-based tracking and communications systems to permit us to stay in contact with our drivers, obtain load position updates, and provide our customers with freight visibility. A significant number of our trailers are equipped with tracking technology to allow us to manage our trailers more effectively, maintain a low trailer to tractor ratio, efficiently assess detention fees, and minimize cargo loss.

We continue to expand our operating model. We established our refrigerated subsidiary in 2004, and in August, 2005, we expanded the subsidiary with our acquisition of EB. Our refrigerated and dry van subsidiaries are operated as one reportable segment. At September 30, 2005 we ended the quarter with 246 tractors devoted to the refrigerated subsidiary. We established a brokerage subsidiary in July 2005 and are cautiously optimistic that we can achieve meaningful growth in that business. For the quarter ended September 30, 2005, the brokerage subsidiary generated less than \$1.0 million in revenue. This brokerage business model, however, differs somewhat from our truckload model because it is non-asset based and generally requires less capital. Although we are optimistic about the prospects for the new subsidiaries, the primary source of our revenue growth remains our ability to open and develop new regional service centers in certain geographic areas and operate them at or near our targeted margins within a relatively short period of time. Our most recent opening was a dry van operations center in Reno, Nevada that commenced operations after the quarter ended September 30, 2005. During the third quarter of 2005, we grew our tractor fleet by 186 tractors, including the EB acquisition. Based on our current expectations concerning the economy, we anticipate adding a total of approximately 100 to 150 new tractors system-wide over the remainder of the year. As part of our growth strategy, we also periodically evaluate acquisition opportunities that meet our financial and operating criteria.

### ***Revenue and Expenses***

We primarily generate revenue by transporting freight for our customers. Generally, we are paid a predetermined rate per mile or per load for our services. We enhance our revenue by charging for tractor and trailer detention, loading and unloading activities, and other specialized services, as well as through the collection of fuel surcharges to mitigate the impact of increases in the cost of fuel. The main factors that affect our revenue are the revenue per mile we receive from our customers, the percentage of miles for which we are compensated, and the number of miles we generate with our equipment. These factors relate, among other things, to the general level of economic activity in the United States, inventory levels, specific customer demand, the level of capacity in the trucking industry, and driver availability.





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Historically, excess capacity in the transportation industry has limited our ability to improve rates. From 1999 into 2003, economic activity in the United States was somewhat sluggish, which limited to some extent our ability to obtain rate increases during that period, but also resulted in decreased truck capacity in relation to demand as many trucking companies failed, contracted, or limited their growth. Beginning in 2003 and throughout 2004, however, the United States economy experienced strong growth, which, together with tighter capacity, contributed to higher freight rates throughout much of the industry, including our 7.6% improvement in average revenue per loaded mile (excluding fuel surcharge) from 2003 to 2004. If the economy continues at the 2004 pace, we expect continued tight capacity, coupled with stronger freight demand, to continue to provide us with better than historical pricing power. In the third quarter of 2005, our average revenue per loaded mile (excluding fuel surcharge) increased by 5.6% over the same quarter in 2004.

The main factors that impact our profitability in terms of expenses are the variable costs of transporting freight for our customers. These costs include fuel expense, driver-related expenses, such as wages, benefits, training, and recruitment, and independent contractor costs, which are recorded under purchased transportation. Expenses that have both fixed and variable components include maintenance and tire expense and our total cost of insurance and claims. These expenses generally vary with the miles we travel, but also have a controllable component based on safety, fleet age, efficiency, and other factors. Our main fixed costs are the acquisition of long-term assets, such as revenue equipment and terminals.

### ***Recent Results of Operations and Quarter-End Financial Condition***

For the quarter ended September 30, 2005, our results of operations improved as follows versus the same period in 2004:

- Revenue, before fuel surcharge, increased 20.1%, to \$127.4 million from \$106.1 million;
- Net income increased 23.0%, to \$15.5 million from \$12.6 million; and
- Net income per diluted share increased 22.7% to \$0.27 from \$0.22.

We believe the improvements in our profitability are attributable primarily to higher average revenue per tractor per week (excluding fuel surcharge), our main measure of asset productivity, which increased 3.4% to \$3,159 in the third quarter of 2005 from \$3,057 in the third quarter of 2004. This improvement was driven by a 5.5% increase in average revenue per loaded mile (excluding fuel surcharge) to \$1.642 from \$1.556. This rate improvement was partially offset by a 1.9% decrease in average miles per tractor to 28,308 from 28,834 and a 2.6% increase in our percentage of non-revenue miles to 11.6% for the third quarter of 2005 from 11.4% for the same quarter in the prior year. The decline in miles per tractor was primarily due to the hurricanes in the South this quarter affecting our Gulfport, MS, and Katy, TX operations, along with somewhat softer freight demand at pricing acceptable to us during the 2005 quarter versus the 2004 quarter. The increase in non-revenue miles principally was due to positioning of our revenue equipment in areas which allowed us to capitalize on the most favorable freight in terms of the highest rates.

At September 30, 2005, our balance sheet reflected a combined \$26.9 million in cash and short-term investments, no long-term debt, and shareholders' equity of \$333.7 million. For the quarter, we generated \$9.0 million in cash flow from operations and used \$28.5 million for net capital expenditures, excluding the EB acquisition.

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The following table sets forth the percentage relationships of our expense items to total revenue and revenue, before fuel surcharge, for the three-month and nine-month periods ended September 30, 2005, and 2004, respectively. Fuel expense as a percentage of revenue, before fuel surcharge, is calculated using fuel expense, net of surcharge. Management believes that eliminating the impact of this sometimes volatile source of revenue affords a more consistent basis for comparing our results of operations from period to period.

(Total revenue)		(Revenue, before fuel surcharge)		(Total revenue)		(Revenue, before fuel surcharge)	
<b>Three-Month</b>		<b>Three-Month</b>		<b>Nine-Month</b>		<b>Nine-Month</b>	
<b>Period Ended</b>		<b>Period Ended</b>		<b>Period Ended</b>		<b>Period Ended</b>	
<b>September 30,</b>		<b>September 30,</b>		<b>September 30,</b>		<b>September 30,</b>	
<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>