INDUSTRY NOTE

Stephens

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Covered Companies Mentioned:

CGI	**$6.35**
CVTI	**$27.09**
HTLD	**$23.22**
KNX	**$44.88**
MRTN	**$20.60**
SNDR	**$27.70**
USAK	**$18.46**
WERN	**$38.25**

Industrials: Transportation/Trucking

Reason for Report: Industry Update

4Q'17 TL Preview: Expect Best Peak Season in Years, Setting up Well for 2018

INVESTMENT CONCLUSION:
We believe the TL environment was strong in 4Q'17, a function of better demand (both broad-based and peak season related) combined with ongoing supply side constraints with a severe driver shortage. We saw this translate into accelerated spot rates, up ~20% yoy on avg. during the qtr., and believe this tight capacity and improved demand environment set the stage for more meaningful contractual rate improvement than previously thought, with many shippers and carriers expecting mid- to high-single-digits this bid season per our recent channel checks. While stocks continue to look expensive, we remain mostly **OW** rated the group as we see 1) a positive demand environment likely to continue with healthy GDP forecasts 2) continuing supply constraints in the form of driver shortages and 3) positive implications from tax reform, all of which are positive for TL fundamentals and momentum, in what we view as a multi-year upcycle.

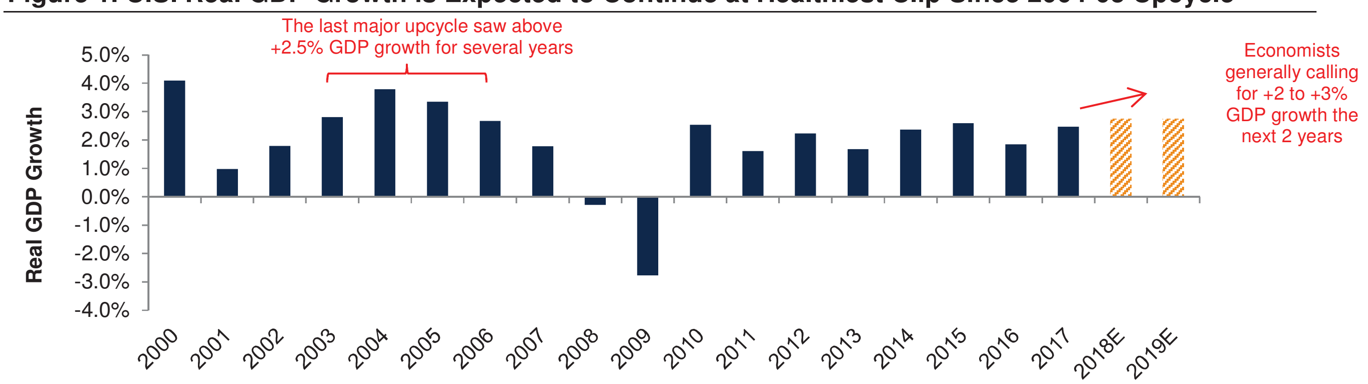
KEY POINTS:
Estimate and Price Target Changes. We have updated our ests. and are calling for Truckload (TL) results, generally speaking, to be above current cons. expectations for the quarter, a function of improved utilization in a tight TL environment as well as more premium freight opportunities in the qrtr. We also raised our longer-term outlook and are now ~19% above consensus for both 2018 and 2019 on average for the group, as our ests. include lower tax rate, likely not fully baked into Street ests. yet. We also adjusted our price targets to reflect these estimate changes/valuation multiples given where we are in the cycle. (See Figure 6 for a summary of all of our EPS and target price changes).

What Positive Data Points Are Expected / To Look for on the Prints. Recall last quarter, we saw many carriers report weaker utilization levels (avg. miles/ tractor) in the face of disruptive hurricanes (Harvey and Irma). We believe the subsequent rebuilding/ replenishment efforts that followed these events earlier in the quarter combined with strong peak season demand that developed later in the quarter, should both have positive impacts on utilization levels across the TL group. From a rate (rev./loaded mile) perspective, we believe the carriers were able to procure more premium freight opportunities this peak season and be more selective with freight in their networks, which should bode positively on reported rates in the quarter. Combined with anticipated driver wage increases that have yet to be announced/ go in effect from the public TL carriers, we expect to see margin expansion generally across the group (both sequentially and yoy).

What Concerns to Have Into the Prints? We believe the only negative themes heading into 4Q'17 results will be centered around 1) elevated Purchased Transportation (PT) costs related to outsourcing additional freight capacity in a very tight TL market and 2) potential announcements of upcoming driver wage increases. While we believe both of these issues are in fact signs of strong TL fundamentals, we believe margin expansion opportunities from some carriers might be slightly hindered by elevated PT costs, especially for carriers with more peak season exposure, such as CVTI. The broad-based driver shortage continues to be a very significant problem per our checks, with the improving demand environment + full labor market only adding pressure in attracting drivers towards more lucrative and better lifestyle jobs. We believe carriers will start to announce new rounds of driver pay increases in the near-term and believe any discussions around driver wage increases will be an important topic on earnings conference calls.

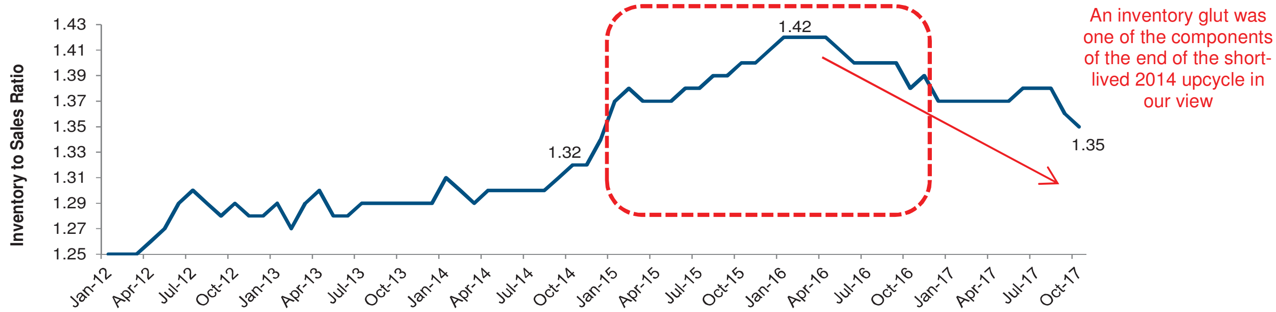
Thoughts on 2018-19 & Why We Believe This Will be a Multi-Year Upcycle. We believe this freight cycle is setting up to be a multi-year upcycle, more similar to the 2004-05 upcycle than the shorter-lived 2014 cycle. As shown in Figure 1 below, U.S. Real GDP growth during the 2014 upcycle was +2.4% for the year, with GDP actually inflecting negative in 1Q'14 (-0.9%). Consequently, we believe what actually drove the last upcycle was a series of capacity constraints in the forms of 1) the "Polar Vortex" in 1Q'14 which hampered highways and freight traffic 2) slower train speeds which shifted some IM volumes to OTR in our view, and 3) the complete HOS regulations that were in place, which we believe in total took out 2%-3% utilization capacity in the industry (in December 2014 the 34 Hour Restart provision was suspended). In the 2004-05 upcycle, we saw GDP growth above 2.5% for several consecutive years and with economists calling for GDP growth to be between 2% and 3% for the next 2 years, we believe the demand side of the equation is setting up for the multi-year upcycle as we saw nearly 15 years ago. Additionally, we believe supply constraints in the forms of 1) continued driver recruitment/ retention challenges in a full labor market 2) ELD enforcement on April 1, 2018 and 3) used equipment values that are ~33% below where they were in 2014 and likely to remain pressured post-ELD mandate, in our view, and understanding that used equipment values typically support the purchase of new equipment, all should set the stage for TL fundamentals to remain strong given the healthy economic backdrop. With our updated estimates, we now project Oper. EPS growth of 68.4% (20% of this increase was due to lower tax assumptions as shown in Figure 3 on page 3) in 2018 and 21.2% in 2019 on average for the public TL carriers.

Figure 1. U.S. Real GDP Growth is Expected to Continue at Healthiest Clip Since 2004-05 Upcycle



Source: U.S. Bureau of Economic Analysis, private-sector economists and Stephens Inc. estimates.

Figure 2. Inventory Levels Have Been Rightsizing, Setting Up Well for Restocking in Healthy Economy



Source: U.S. Bureau of the Census and Stephens Inc.