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PRESENTATION

Operator

Good afternoon. My name is John and I will be your conference operator today. At this time I would like to welcome everyone to the Knight-Swift Transportation Second Quarter 2024 Earnings Call. All lines have been placed on mute to prevent any background noise. If at any time during this call you require immediate assistance, please press star zero for the operator. Speakers for today's call will be Adam Miller, Chief Executive Officer; Andrew Hess, Chief Financial Officer; Brad Stewart, Treasurer and Senior Vice President of Investor Relations. Mr. Stewart, the meeting is now yours.

Brad Stewart, Treasurer & Senior Vice President, Investor Relations, Knight-Swift Transportation Holdings Inc.

Thank you, John, and good afternoon, everyone, and thank you for joining our second quarter 2024 earnings call. Today we plan to discuss topics related to the results of the quarter, current market conditions, and our earnings guidance. We have slides to accompany this call, which are posted on our investor website. Our call is scheduled to last one hour. Following our commentary, we will answer questions related to these topics. In order to get to as many participants as possible, we limit the questions to one per participant. If you have a second question, please feel free to get back in the queue. We will answer as many questions as time allows. If we're not able to get to your question due to time restrictions, you may call 602-606-6349.

To begin, I will first refer you to the disclosures on slide two of the presentation and note the following: This conference call and presentation may contain forward-looking statements made by the Company that involve risks, assumptions, and uncertainties that are difficult to predict. Investors are directed to the information contained in Item 1A Risk Factors or Part 1 of the Company's annual report on Form 10-K filed with the United States SEC for a discussion of the risks that may affect the Company's future operating results. Actual results may differ.

Now I will turn to our overview on slide three. The charts on slide three compare our consolidated second quarter revenue and earnings results on a year-over-year basis. Revenue, excluding fuel surcharge, increased 18.1% due to the acquisition of U.S. Xpress in July of last year. Our adjusted operating income declined by 22.8%. GAAP earnings per diluted share for the second quarter of 2024 was \$0.13 and our adjusted EPS was \$0.24. These results include a \$12.5 million pre-tax charge for the settlement of a large auto liability claim from 2020. This settlement negatively impacted our adjusted EPS by \$0.06 per share. Excluding the settlement, our adjusted EPS would have been \$0.30 for the quarter. Our results were also negatively impacted on a year-over-year basis by a \$17.8 million increase in net interest expense and the 11.3% increase in the effective tax rate on our GAAP results and 5.3% increase in the effective tax rate on our non-GAAP results year over year. Impairment, severance, and legal accruals totaling \$6.5 million are also excluded from our non-GAAP results.

Now on to the next slide. Slide four illustrates the revenue and adjusted operating income for each of our segments. In general, our truckload, logistics, and intermodal segments continue to navigate a challenging full truckload market. Domestic inland freight demand has yet to show the strength seen in the ocean container market and the ongoing attrition of excess trucking capacity added during the up cycle still has further to go. Freight rates have largely stabilized, but at unsustainable levels. The LTL segment continues to experience a much more supportive market, where rate increases remain consistent. The combination of seasonal demand improvement, stable pricing, and moderating cost inflation supported sequential improvement in operating results across our businesses during this quarter. The market is giving more and more signs of being balanced. Acute customer needs are increasingly noticeable. Trailer pools are starting to be valued again and scale and service are becoming more of a differentiator. These are all signs that align with the unique value that we are positioned to create for our customers when the market strengthens. For now, we remain focused on disciplined pricing, cost control, operational excellence, and collaborating across our unique suite of brands to create distinctive solutions.

Now I'll turn it over to Adam to discuss our truckload business on slide five.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Thank you, Brad, and good afternoon, everyone.

For the truckload segment, demand has yet to truly break out and further attrition of excess capacity is still needed. We have a long way to go to return to our target levels of performance, but it is starting to feel like the bottom is behind us for this cycle. In short, I think the story on our truckload business for the second quarter is one of stabilization and a seasonal build in demand.

We saw steady demand that has generally followed seasonal patterns since March develop into an uptick in June. This was fairly broad based as a number of customers look to secure additional capacity to support elevated volumes. This helped to support a stabilization in revenue per mile a quarter earlier than we had anticipated as well as an improvement in utilization. It's too early to call this a trend and for it to be a material driving force around our earnings, but in prior cycles this would indicate the early signs of a market setting up to change. There has been some moderation in demand in the two weeks since the Fourth of July holiday, which is in line with the typical seasonal pattern. If the trends over the past few months continue, we should see demand building as we exit the third quarter and some return of seasonal activity for the fourth quarter for the first time in years.

On a year-over-year basis, our truckload revenue, excluding fuel surcharge, for the second quarter increased 33%, reflecting a 5.7% decline in the legacy truckload business prior to the inclusion of U.S. Xpress. The year-over-year decline in revenue per loaded mile, excluding fuel surcharge, narrowed to 5.5% in the current quarter as rate held stable with the first quarter. Further, our spot exposure remained relatively consistent with where we entered the second quarter. Miles per tractor increased 8.5%, largely driven by our earlier decision to reduce the number of unseated tractors in our legacy businesses to reduce cost. Excluding U.S. Xpress, revenue per tractor, excluding fuel surcharge, increased 3.5% year over year, which was the first year-over-year increase in six quarters as the improved miles per tractor while the decline in pricing decelerates. U.S. Xpress experienced modest sequential declines in revenue and miles for the quarter as a result of some churn in its freight portfolio; however, sequential progress on revenue per-mile and stable costs helped offset these challenges to hold the operating ratio flat with the first quarter.

We are preparing our businesses in the trough to maximize the benefits of operating leverage when the cycle turns. When considering the sequential progression from the first quarter into the second quarter, our truckload segment was able to turn flat cost per mile, flat revenue per mile, and a 1% improvement in total miles into a 7% improvement in adjusted operating income, and this includes the \$12.5 million second quarter charge for the claim settlement discussed earlier. If not for the claim settlement, the sequential improvement in adjusted operating income would have been 50%.

Now on to slide six, where we cover our LTL segment. Market conditions in the LTL industry remain much more supportive than in truckload, allowing for steady rate increases through the first half of the year. Our LTL business grew revenue, excluding fuel surcharge, 15.1% year over year as shipments per day increased 8.4% and revenue per hundredweight, excluding fuel surcharge, increased 13.4% year over year. While weight per shipment was down

4.7% year over year in the second quarter, it was flat with the first quarter. Adjusted operating income grew 8.2% year over year as the adjusted operating ratio of 85.9% was fairly in line year over year.

Since acquiring AAA Cooper and MME in 2021, we have acquired or assumed the leases on 56 additional properties. We opened 11 new locations during the second quarter and expect to open another 20 terminals by the end of 2024. Overall, the 38 locations planned to open in 2024 will add over 1,000 doors to our network, representing a 22% increase to our door count from the beginning of the year, which we believe will meaningfully impact the reach of our service offering and increase the density of our network. We expect these investments will bring opportunities to service additional freight end customers. While these new locations initially bring margin headwinds in the form of setup costs and operational inefficiencies, we expect that, as the locations continue to scale, and particularly as they participate in the next bid cycle, they will help drive growth and margin expansion in the business. We remain encouraged by the strong performance within our LTL segment and we continue to look for both organic and inorganic opportunities to geographically expand our footprint within the LTL market. Filling out a super-regional network in the short term and ultimately creating a national network will allow us to participate in more freight and enable us to find opportunities to further support our existing truckload customers with LTL capacity.

Now moving to slide seven, the logistic market continues to be difficult as volumes which were already soft are now further challenged by a number of shippers allocating more of their business to asset-based providers. Gross margins have been under pressure for a few quarters as purchase transportation costs offered little room for relief. Beyond these general market dynamics, our logistics business can face additional challenges in a down market because we divert some volume to support our asset business; however, this headwind should flip to a tailwind when the market turns, as the asset division will overflow freight to the logistics business, particularly for our power-only service. This relationship with our asset division can create more volatility through a cycle for the logistics business, but it means there is significant amount of runway ahead for our logistics business at this point in the cycle.

We remain disciplined on price, which is a headwind to volumes, but allowed our logistics business to sequentially improve profitability in the second quarter while load count remained stable. Revenue increased 11.8% year over year, driven by an increase in revenue per load as load count was flat, reflecting the inclusion of U.S. Xpress in the current quarter, which offsets the 25% year-over-year decline in load count in the legacy business. After first turning modestly positive last quarter, revenue per load increased 10.8% year over year in the second quarter, representing a 4.6% increase from the previous quarter. The year-over-year increase in revenue per load is largely driven by the inclusion of U.S. Xpress logistics in the current quarter as it has a different business mix. We continue to leverage our power-only capabilities to complement our asset businesses, build a broader and more diversified freight portfolio, and to enhance the returns on our capital assets.

I'll now turn it over to Andrew Hess for slide eight.

Andrew Hess, Chief Financial Officer, Knight-Swift Transportation Holdings Inc.

Thanks, Adam.

In our intermodal business, we grew load count sequentially by 10.8% while maintaining stable revenue per load as compared to the first quarter, which helped improve the operating ratio by 380 basis points over the first quarter. On a year-over-year basis, the operating ratio improved by 460 basis points. Revenue decreased 6.5% year over year, driven by a 4.9% decrease in revenue per load and a 1.7% decrease in load count. The year-over-year decline in revenue per load narrowed from recent quarters as we have now lapped the loss of project revenue in the prior year. We anticipate sequential volume growth into the second half based on progress in the bid season, which should help us execute our strategy of diversifying our business mix, building density, reducing empty moves, and reducing costs. We expect progress in these areas should make this business modestly profitable for the fourth quarter.

Now on to slide nine. Slide nine illustrates our all other segment. This category includes support services provided to our customers, independent contractors, and third-party carriers such as equipment sales and rentals, equipment leasing, warehousing activities, insurance, and maintenance. All other segments also includes certain corporate expenses, such as the \$11.7 million of quarterly amortization of intangibles related to the 2017 merger between Knight and Swift and certain acquisitions. For the quarter, revenue declined 47.5% year over year, largely as a result of winding down our third-party insurance business in the first quarter. The \$3.9 million operating income within our all other segment is the first operating profit for this category in seven quarters and was primarily driven by the warehousing and equipment leasing businesses.

On slide 10 we have outlined our guidance and key assumptions, which are also stated in the earnings release. Because of the timing of an inflection has proven especially difficult to predict during this cycle, we are not incorporating an inflection in market conditions for the purposes of these forecasts but rather are based in these ranges on expected seasonality and the continuation of existing market conditions, similar to what we have felt in the second quarter and into July thus far. Based on these assumptions, we expect our adjusted EPS for the third quarter will be in the range of \$0.31 to \$0.35 and our adjusted EPS for the fourth quarter will be in the range of \$0.32 to \$0.36.

The key assumptions underpinning this guidance include the following: for our truckload segment, revenue up slightly sequentially in the third quarter and again in the fourth quarter with sequential improvements in operating margins each quarter resulting in adjusted operating ratio steadily improving into the low to mid-90s; tractor count down modestly sequentially in the third quarter before stabilizing for the fourth quarter; miles per tractor increasing low single digit percent year over year in the third and fourth quarters as prior year comparisons begin to include U.S. Xpress. For our LTL segment, low double-digit percent growth in revenue, excluding fuel surcharge, year over year as shipment count in the third and fourth quarters improves mid single percent year over year and revenue per hundredweight, excluding fuel surcharge, improves high single digit percent year over year, and adjusted operating ratios in the mid to high 80s as a result of normal seasonal progression and as we continue to expand our network. For our logistics segment, load count sequentially growing mid single digit percent in the third quarter and stabilizing into the fourth quarter with adjusted operating ratios in the mid-90s. For intermodal, load count sequentially growing high single digit percent in the third quarter and stabilizing into the fourth quarter with an operating ratio modestly below breakeven by the fourth quarter. In all other segments, before including the \$11.7 million of quarterly intangible amortization, we expect operating income of approximately \$10 million to \$15 million for the third quarter and modestly negative for the fourth quarter as some of these services experience are typical seasonal slowdown. Additionally, we project equipment gains to be in the range of \$5 million to \$10 million per quarter, net interest expense to be up modestly sequentially in the third quarter and fourth quarter.

In summary, we project truckload operating income to improve sequentially into the third and fourth quarters. We also expect the normal seasonal step down in LTL earnings and activities within our all other segment in the fourth quarter, which will largely offset the projected ramp-up in the truckload profits given the suppressed current truckload earnings level at this point in the cycle. Our expected adjusted EPS ranges are based on the current truckload, LTL, and general market conditions, recent trends, and the current beliefs, assumptions, and expectations of management. Actual results may differ.

While we can't drive the timing of any change in the market dynamics, we believe we have positioned our business to endure a difficult market and to be prepared to rapidly improve margins and cash flow when we begin to experience an inflection in the market, similar to our performance in previous cycles. In closing, we are compelled by the outsized runway ahead of us for improving earnings of both our legacy and newly acquired businesses, driving significant free cash flow through cycles and leveraging a disciplined approach to deploying capital to further increase the capital generating power of our company through successive cycles.

That concludes our prepared remarks. Before I turn it over for questions, I want to remind everyone to keep it to one per participant. Thank you. John, we will now open the line for questions.

QUESTION AND ANSWER SESSION

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press star followed by the number one on your touchtone phone. You will hear a prompt that your hand has been raised. Should you wish to decline from the polling process, please press star followed by the number two. If you are using a speakerphone, please lift the handset before pressing any keys.

Your first question comes from the line of Chris Wetherbee from Wells Fargo. Your line is now open.

Chris Wetherbee, Wells Fargo

Thanks. Good afternoon, guys. Maybe just on the truckload outlook as you think about 3Q and then 4Q in particular, I guess you noted the seasonal improvement we saw in the second quarter. I guess how close are we getting back to

sort of that relationship between supply and demand? And I guess, as you think about the third quarter, what is included from a seasonal perspective in the outlook? I guess we're just trying to make sure or to get sense of how you guys are thinking about a potential ramp. Or is it really more of the same until we get to a better supply/demand environment?

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Yeah, I'll take that, Chris. Good to hear from you. You know, it does feel like we're getting a lot closer to a balanced market. And what would lead us to that is just the seasonal uptick we saw as we came to a close of the second quarter and got into the holiday for the Fourth of July where we saw many of our customers somewhat trying to secure additional capacity where their routing guides were starting to fail. We saw rejections pick up on some of the third-party data as well as our own data and that's one of the first indications that the supply chain does not have enough slack into it to absorb some incremental demand. And then, as we noted in our prepared comments, that we did see a little bit of a slowdown following the holiday, which is typical, and we'd expect that to start to ramp up as we get closer to the holiday season.

And so I think when we think about the guidance for Q3 and Q4, we'd expect to see, in an improving environment, which we think we're in and the bottom is behind us, that the OR would see some progression in terms of improvement from Q2 to Q3, and that could be in the 100 to 150 basis point range, and then from a Q3 to Q4 kind of a similar range could be 150 to 200 basis points. And if you look at how, especially from Q3 to Q4, how that's trended over the cycles over the last probably six years, we've probably averaged around close to just shy of 200 basis points improvement in the OR from third to fourth. Now certainly in an environment where there's a lot less supply than demand, that number could be larger, closer to 400 basis points, and then in an environment where we see too much supply you could see that number even coming off from third to fourth.

So we're projecting somewhat of a kind of a normal type of uplift, it's just coming off a lower base, obviously. And so we're going to have a lot of work to do to improve those margins kind of over time, but I do feel, based on the way our volumes have trended and rejections and some other data points, that when we come across the next bid season that we should be in a position where rates should be going up across the board, you know, in the next bid season, it's just a matter of by how much. And that will be really determined by what we see in the fourth quarter in terms of the acute demands from our customers, or maybe lack thereof, but I think there's really not a scenario today where I see rates going down in the next bid cycle.

When I think of where we landed here in the most recent, like kind of tail end of the bids, we still felt pressure from certain customers to reduce our rates, and some at almost double-digit levels, but clearly we don't have that to give. Now maybe there are some private companies that maybe don't have the same discipline as us that would be willing to sacrifice that rate, but clearly we couldn't and I don't think some of our public peers can as well, and so we've held the line. And I think what we've found is we were still awarded a healthy amount of the business that we bid on even at small increases when customers were looking for big decreases, because I think they're understanding that the market is coming closer to balance and that they probably need to begin to secure quality capacity and reduce their reliance on maybe brokers or smaller carriers. And so we expect that trend to just play out, but it just could take longer than maybe some had hoped. But hey, things can move fast in this space. We know that. It's hard to forecast and predict and so we're kind of cautious on trying to predict the inflection, because it's been, probably we've been saying 6 months for probably 12 months now, so we're taking more of a cautious approach and expecting just seasonality to play out like we've been seeing and, hey, maybe if that moves more rapidly, maybe there's some upside to that.

Chris Wetherbee, Wells Fargo

Just a point of clarification there. As you think about that progression, does that get you kind of back to flattish maybe give or take versus the fourth quarter of last year from a profit perspective in truckload?

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Yeah, I think there's probably some opportunity for truckload to be a bit better than it was last year from a profit standpoint. I think one thing we have to consider when you're looking at our overall business now, the composition has changed quite a bit since maybe 2018, 2019, periods that you might be comparing against, because we've layered on LTL and that has maybe different seasonality than truckload. And then we also have in our all other segment some non-trucking businesses, particularly our warehousing and some of the equipment and leasing

business, that maybe works counter-seasonal where you see a lot of strength in the first three quarters and maybe a lot less in the fourth quarter. So some of that offsets some of the strength you would see in truckload. I mean we like that, I think that will show more consistency over time, it's just I think you may not see the same kind of lift sequentially from Q3 to Q4 as you would have typically seen when we were primarily a truckload company.

Andrew Hess, Chief Financial Officer, Knight-Swift Transportation Holdings Inc.

Chris, I'd add maybe one other point. We expect, yeah, I think roughly what you said is right, but we expect USX to start contributing income, which it wasn't doing last fourth quarter. So I think we expect that to happen here in the back half. And it's going to be a process to get where we need to be on U.S. Xpress, but there will be a contribution in our view in the fourth quarter.

And maybe another point, another indicator that we watch that we think has some meaning that we've watched occur over the last few months, unplanned freight right now is not being secured at a discount any longer. Earlier in the year we saw backup freight or spot freight that we were securing was going at a discount to our primary rates and over the more recent period we're seeing that flipped and we're seeing a small premium on those unplanned demand. So, just another indicator that it's going to be a process, but we are seeing a movement in that direction that's encouraging.

Chris Wetherbee, Wells Fargo

Thank you very much. Appreciate it.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Thanks, Chris. Appreciate it.

Operator

Your next question comes from the line of Ken Hoexter from Bank of America. Your line is now open.

Ken Hoexter, Analyst, Bank of America

Hey. Great. Good afternoon, Adam, Andrew, and Brad. So I guess just a little surprised given the commentary of improving backdrop maybe just, you know, as we look at spot rates on the load boards kind of near decade lows, not just pulling back seasonally but just so weak. Maybe you can help us kind of interpret why that is. And then also, we saw a lot of freight come into to the West Coast but then we're not really seeing kind of a flow-through of that into the system. Is there, I don't know, is there a rebuild of inventory somewhere around the chain or is that prepped and ready to go as we go into peak season, giving you maybe more confidence as you move into the fall? Maybe work through those issues. Thanks.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

What was the first part of the question, Ken?

Ken Hoexter, Analyst, Bank of America

It was, you know, just surprised on the commentary of the return to seasonality. I know you said it pulls back at this point in July but yet on some of the load boards we're seeing kind of spot rates near decade lows, not just low but decade lows in terms of where they are on the boards, and that just kind of makes it seem like the environment is even kind of weak, like at COVID weak, in terms of the demand out there. So I'm just wondering why the differentiation of your confidence in looking forward and what at least the spot rates on the load boards are suggesting.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Yeah, I think, you know, I think we have maybe a different purview of the market because of the different brands that we have, you know, sizable brands that operate in different networks, and so we would look at a combination of our own data as well as what we see on third-party data. One of the metrics we would focus on would be the number of rejections that the industry is seeing and that picked up quite a bit, hit a level we haven't seen probably since 2022 during the Fourth of July, and it came back down but not back to where it was. It actually leveled out at levels that were similar to what we saw during Memorial Day. So I think that tells us still that it's not as easy to find capacity for some of our customers.

We also look at the different projects that we have ongoing and these are projects, as Andrew alluded to, that pay a premium, and although some of them have scaled back since the holiday, we still have several ongoing throughout all of our larger trucking companies. So we've got U.S. Xpress, we've got Swift, we've got Knight that are still participating in premium-type freight where customers need help and they're securing capacity to do so.

So those are maybe some indications that we see in our own business rather than just looking at third-party data and then also just discussions that we have with customers. And it feels like many of them feel comfortable with where they're at from an inventory standpoint and I think even surveys have been done would illustrate that as well and that many feel like, yeah, the market is in balance and, hey, there's probably some lift that we're going to see in the fourth quarter. So that's just some commentary, it's kind of anecdotal, but those are some large shippers that we're having discussions with as we try to plan out our fourth quarter.

Now I still think there's a little bit of unknown of what that could look like in the fourth quarter, because normally you have discussions around those plans in August, maybe even early September, where we start talking about potential projects or tiered pricing or where they may have some surge needs. So I think there's more to come there, but we would certainly feel better about the market today than we would have certainly three months ago or six months ago. And I think your other question was on, was it truckload? Oh, the West Coast.

Ken Hoexter, Analyst, Bank of America

Yeah, the West Coast volumes that came in. Yeah, yeah.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Yeah. I think we've seen, and this is talking with maybe different rail partners that we have as well, that there has been a surge in the West Coast, and I think a lot of that volume has moved on the international containers versus the transloading to truckload. But I do feel like, as volume starts to pick up and truckload capacity becomes a little more scarce, that we'll have some need to transload. I think that starts to convert to truckload. But right now it does feel like a lot of that is going on the international containers. But when there's a need for those containers and they start to pick up, they're going to have to transload, and that could go intermodal or could go to truckload.

Ken Hoexter, Analyst, Bank of America

Thanks, Adam. Appreciate the thoughts.

Operator

Your next question comes from the line of Ravi Shanker from Morgan Stanley. Your line is now open.

Ravi Shanker, Analyst, Morgan Stanley

Great. Thanks. A couple of follow ups here. Adam, you said, obviously, thanks for all the data that shows that you're seeing signs of improvement, but you also said that you don't think this is a trend just yet. So what would you need to see to believe that this is real? Like is it some particular data set? Is it continuation with just time? Is it a certain level of price? Kind of what makes you think that this is going to be a continued trend? And also on the LTL side, the impressive door growth there organically, are you shifting your mix between organic and potential inorganic growth there given that it's taken a little bit of time to consummate that deal? Thank you.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Yeah. So maybe I'll hit the LTL piece. Yeah, we're certainly excited about the opportunity that we had to pick up some properties due to the Yellow bankruptcy and so we've got the team hard at work rolling those terminals out and building volumes in those markets. And it does take a little time and so it creates a little bit of a headwind from a margin standpoint because of the costs associated with that, but we feel like having those markets opened up, allowing us to participate in spot activity in the near term and then as we get into the next bid season, I think, pick up some additional volume that get those terminals back to more of an optimal level, really helps us grow from a top line but also from a margin perspective, and so I think we've got a lot of work ahead of us on that front.

I think we've been very open about also wanting to grow inorganically and clearly we have the southwest and the northeast as areas where we have a need. And I think we haven't done a transaction since MME in 2021 so we feel like the next 12 months that, you know, I think we'd be disappointed if we weren't able to get a transaction, at least one transaction done to help fill in some of the gaps in those markets. So we think we can do both, Ravi. We're going

to continue down the organic front and when we find the right partner and has the right leadership and it's going to be the right fit in the organization, we'll be very quick to pull the trigger on that, because we believe building out a nationwide LTL has a lot of benefits, not just from increased profitability and service for our customers but also I think there's a lot synergies that can align with our truckload business as well.

I think, Brad, you have something to add to this.

Brad Stewart, Treasurer & Senior Vice President, Investor Relations, Knight-Swift Transportation Holdings Inc.

I was just going to add, Ravi, that to get to the growth targets that we want to hit and the time line we want to hit them, it's going to take both the organic and the inorganic running in parallel. With the need to fill out those regional gaps in the southwest and the northeast, the puzzle pieces you're left with are going to be regional, and so if you consider the sizes of the likely available targets out there, it's going to take organic in complement to inorganic transactions to really fill that out and hit our growth targets. So it's not an either/or. It's both.

Ravi Shanker, Analyst, Morgan Stanley

Yeah, the first one was just what do you need to see on the data to believe that this is real?

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Yeah, I think, Ravi, I think we just need to see how things play out in the third quarter. If we do in fact see the seasonal uptick as you get probably through the back half of August and really into September, then I think we would have more confidence that this is maybe a trend that we would expect to continue into fourth quarter and lead to a much more favorable bid season into next year. But again, you have the little, the lull that you see following the Fourth of July. That is normal. And we just need to see that that builds back. And then also just the conversations we're having with customers and them helping us understand what their needs are. So we don't want to be too quick to call it, but I think we're cautiously optimistic that certainly the trough is behind us and we're on our way to building back. And Andrew, you wanted to add to this?

Andrew Hess, Chief Financial Officer, Knight-Swift Transportation Holdings Inc.

I'd say one of the things we pay a lot of attention to that I think has meaning, particularly as we have so many signals across our different brand, is when we see freight behaving outside of seasonal patterns. In other words, we see strong freight when it shouldn't be seasonally. And that's an indication for us that there's something different. So we'll pay attention to following the seasonal patterns but also where is it strong when it shouldn't be. And we've got a lot of signals to that to tell us when that's happening and so that will be one indicator for us.

Ravi Shanker, Analyst, Morgan Stanley

Understood. Thank you.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Thanks, Ravi.

Operator

Your next question comes from the line of Scott Group from Wolfe Research. Your line is now open.

Scott Group, Analyst, Wolfe Research

Hey, thanks. Good afternoon, guys. So I wanted to just clarify something with respect to the guidance. So it looks like you're assuming a much higher tax rate now and so is that right and why? Assuming that we're looking at this right, then are you effectively sort of raising the third quarter like operating guidance? I just want to make sure we're thinking about this right. And then, Adam, can you just clarify, you also said that truckload margin should improve 100 to 150 basis points Q2 to Q3. Is that based on the reported number or the adjusted if we exclude the impact of claim? Thank you.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Sure. So, on the tax rate, Scott, maybe without, I don't want to get too technical here, tax has some temporary and permanent differences that drive the effective tax rate. When you have a lower operating income, those permanent differences have a bigger impact on your tax rate. So, because the operating income is lower than it was the previous year, that has effectively raised our effective tax rate. I think as we see margins build, operating income

improve, which we would expect for next year, we would believe that tax rate would come back to a more normalized level. When we think about Q3 and now applying that higher tax rate, I do feel like we've now forecasted a little bit stronger than we would have last quarter and that helps offset the higher tax rate that we're now forecasting.

Scott Group, Analyst, Wolfe Research

Sorry to make you put your CFO back on there, Adam. And then just that question on the truckload OR comment, just the sequential.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Yeah, I think you could see close to 100 basis points on the, call it, the adjusted operating ratio, excluding the claim.

Brad Stewart, Treasurer & Senior Vice President, Investor Relations, Knight-Swift Transportation Holdings Inc.

That's based on the claim being in there in the second quarter. Like I think, Scott, if you're asking is that based on the claim being in or out of the adjusted OR. So, as reported, that adjusted OR with the claim in there still leaves room for the type of step up Adam's talking about.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Yes. So yeah, you adjust that claim out, there's still room for 100 basis point improvement, Scott.

Scott Group, Analyst, Wolfe Research

Very helpful. Thank you, guys.

Operator

Your next question comes from the line of Tom Wadewitz from UBS. Your line is now open.

Tom Wadewitz, Analyst, UBS

Good afternoon. I wanted to ask a little bit about like the pricing assumption. So revenue per loaded mile ex fuel 3Q/4Q, are you thinking that that will start to move up or you think that's kind of flattish? And what are you doing in terms of like percent of fleet in the spot market and kind of how you want that to be positioned if you gain some more confidence in the cyclical upturn looking out a few quarters?

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Yeah. Yeah, sure. So I think when we think about pricing, Tom, we just see some sequential improvement, not a large change. It could just be a percent or two as you go from Q2 to Q3 and Q3 to Q4. Probably a larger lift in Q4 assuming that you have longer seasonality outplay in Q4. And so when we think about our spot-to-contract relationship today, we hang about low double digits, you know, the 10%, 11% between our larger brands. We can flex that certainly if there's opportunity that comes our way and we've, in the past, in really strong markets, have brought that number to 20%, 25%. I don't think we'll have that opportunity in the near term, but certainly we'd be open to flexing that number up based on what opportunities come our way and the pricing on those opportunities.

Andrew Hess, Chief Financial Officer, Knight-Swift Transportation Holdings Inc.

I would say, just maybe to add one comment there, just we've seen rate stability pretty consistently. We kind of expect that outside of the spot premium opportunities. But just from here I think, you know, our anticipation is the rate probably only goes up from here. How fast and to what extent, that we don't know, but we don't anticipate rate pressure down over all of the business and so our assumptions are based on a relatively stable rate environment for the rest of the year.

Tom Wadewitz, Analyst, UBS

And in terms of your percent of trucks and spot, that's been at kind of the same level for a few quarters and you keep it there for a few quarters going forward?

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Yeah, I think those trucks are now more profitable because the spot opportunities, as Andrew mentioned, are more of a premium than a discount. But again, I think, Tom, we would have the ability to flex that up pretty quickly if the right opportunity comes our way.

Tom Wadewitz, Analyst, UBS
Right. Okay, great. Thank you.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.
All right. Thanks, Tom.

Operator

Your next question comes from the line of Brian Ossenbeck from J.P. Morgan. Your line is now open.

Brian Ossenbeck, Analyst, J.P. Morgan

Good afternoon. Thanks for taking the question. I just wanted to see if you could give us a little more color behind U.S. Xpress. It should be improving in this market. I don't know how much of that could be what you would attribute to self-help. If you would ascribe maybe a percentage of market base versus self-help, that'd be useful to kind of figure out how that's progressing right now.

And then just as a follow up to clarify the other segment income turning negative in the fourth quarter and sort of offsetting some of the normal seasonal uplift that you might see, is that really showing up now because insurance is gone and the other segments are still off of a pretty low base and that's why it's a bigger impact or is that something that you think is going to kind of mute the fourth quarter in a more normal environment whenever we end up getting there? Thanks.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Yes. So maybe let me hit the all segment or all other segment. Insurance really blurred those results over the last couple of years and at first it was a positive and then certainly turned to a negative there. But we have some core businesses within the all other segment like our warehousing and equipment leasing that are relatively consistent and typically they play out where they have strong results in the first three quarters and then they see a little bit of a dip and go breakeven, could have a small loss in the fourth quarter. I think that's having a bigger impact in terms of the percentage of the EPS because of just where the truckload margins are today. So that seasonality has always been there, it's just when our truckload business is operating in the low 80s it's just not as readily visible because it's a smaller percentage of the overall income. And so that's why we're calling that out now, Brian, so that you understand why there isn't maybe the same lift from Q3 to Q4 that maybe some would have anticipated. But nothing's really changed in those businesses other than we've just pulled out the insurance, which clearly didn't have any impact to the business, which is a positive. I'm knocking on wood to make sure that we feel that same way here the next quarter.

When I think about U.S. Xpress, the progress there, I mean really all of that's self-help. I mean there really hasn't been any market base support. If anything, that's been a headwind, like it's been to everybody in the industry. And so U.S. Xpress has been able to make some progress despite some of the market headwinds that we were faced with and so we've done a lot of the hard work. We've built out our terminal network of 11 terminals. We've made meaningful progress on costs and are getting closer from a cost-per-mile parity with Knight and Swift. The dedicated business at U.S. Xpress is performing fairly well. That's very close to parity with our Swift dedicated. And logistics is also doing well and that performs very closely to our Knight and Swift logistics businesses. The over-the-road business, the one-way over-the-road is where we have the biggest opportunity and that's also where we feel we have a core competency as an organization. And we've got great leadership there at U.S. Xpress that know how to operate one-way over-the-road capacity, it's just the starting point was just in a really bad spot. We've made some progress there. But as we get some market support I think we would expect that that business really makes some big strides and becomes profitable and begins to close the gap between Knight and Swift. But hey, we'll need a little market tailwind to help with that. But as you've seen some of the seasonality we've talked about, we're introducing some of these projects in the U.S. Xpress business where historically they wouldn't have participated in those. So I think there's some additional markets that they're reaching out to and finding opportunities in, and as we see that change, the market change and improve, we'll continue to find more wins for U.S. Xpress and, again, make some progress. We expect some meaningful progress here in the next year, especially if the market changes.

Andrew Hess, Chief Financial Officer, Knight-Swift Transportation Holdings Inc.

It was always going to take some time to restructure the book of business they were operating under to a network strategy, so there's been a lot of work and lift on to build the type of customers and the kind of network that we know works and that means you got to leave spot market. When we acquired them, they were probably close to half of their demand under the spot market. They're in line now with the rest of our businesses. And as we've done that, it's taken a little time. We've got the right type of customers, the right type of freight that's going to be responsive when the market is ready, and we can operate efficiently. And U.S. Xpress is operating in counter to kind of where the industry as overall is done on rate. So they're probably double digit up year over year on rate and they're probably up mid single digit from first quarter. That's because we've got the right type of customers that are going to be able to respond. And we're going to start to see that a little bit here in the second half, but there's a lot of signs that are encouraging to us that, with a little bit of tailwind, that business has a lot of runway.

Brian Ossenbeck, Analyst, J.P. Morgan

And just a quick follow up. Can you keep the fleet roughly the same size as when you acquired it to hit all those metrics and get the parity, assuming the market, when the market recovers, or do you think you need to shrink that down a little bit?

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

I think, you know, we've come off the fleet some and I think that was maybe more on the dedicated side where we have some accounts that we weren't able to retain or the customer decided to disband the fleet to take advantage of a more attractive one-way opportunity. The goal is that we can keep that fleet stable and make improvement as the market improves.

Brian Ossenbeck, Analyst, J.P. Morgan

Okay. Thanks very much, guys. Appreciate it.

Operator

Your next question comes from the line of Daniel Imbro from Stephens Inc. Your line is now open.

Daniel Imbro, Analyst, Stephens Inc.

Good afternoon, everybody. Thanks for taking our questions. I wanted to ask a follow up, Adam, on the LTL segment. So, obviously, you're adding a good amount of rooftops and doors this year. In the guidance you mentioned you expected revenue per hundredweight, I think, up high singles, so pricing remains supportive, but curious how you envision going to market to fill that capacity. Is it just waiting on the industry to reflect higher where you have more stranded costs in the near term? Curious how you weigh the puts and takes of bringing that capacity on line and ultimately how you fill it. Thanks.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

I think initially when you open up a new territory, I mean you look for some of the 3PLs where you can now add a ZIP code or a certain market and you put your pricing in and you start to see freight begin to flow into those markets, assuming you have competitive pricing. And then you have a sales force there that's knocking on doors, finding opportunities to leverage the new network, and then you have some of your large national bids that now open up for you because you have full state coverage or some additional service area that they're interested in. And then you also, as you build additional scale, you can bring on some larger customers who only like to deal with the largest players. And we have a lot of relationships with those types of shippers on the truckload side and many of them have not utilized our LTL service because we don't have nationwide coverage. And so, as we build this out, they don't all need nationwide coverage, but they need certain scale in certain markets, as we build these out, we'll find some additional opportunities to bring on new customers that we already have relationships on the truckload side. So it's a process to build the volumes up. So, in the meantime, it does create a little bit of a headwind from a cost-per-transaction standpoint, but the yield we've been able to secure helps to overcome that and so we've been able to hold margin relatively flat. And we'll see some seasonal degradation of margin, which is normal for the AAA Cooper MME business in the back half of the year, but as we get stable with these terminals and see the volume begin to flow, we'd expect that puts us in a good position to not only grow top line but to expand margins and have that flow through to the operating income.

Andrew Hess, Chief Financial Officer, Knight-Swift Transportation Holdings Inc.

One other point. We're going to open up 38 locations this year. That increases our door count by 20%. I think one meaningful contributor, you know, this was a heavy organic growth year. Next year we expect to be able to really grow those businesses, because we're going to be active and operating ahead of next year's bid cycle. So that's going to give us a kind of a step function and opportunity to grow that business because we're going to be ahead of that cycle. So our customers are asking for us to participate. They're wanting us—they want options. They want to include us in their bid process. And so we're encouraged that there is a lot of opportunity, but we're being very, very thoughtful about the cost. We grow into that business, we don't overdo it, and to do that, because we understand and we value the need to maintain margin as we grow, but this is a good environment for us to invest because the rate environment has been so favorable.

Daniel Imbro, Analyst, Stephens Inc.

Appreciate the color. Best of luck.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Thanks, Daniel.

Operator

Your next question comes from the line of Jon Chappell from Evercore ISI. Your line is now open.

Jon Chappell, Analyst, Evercore ISI

Thank you. Good afternoon. Adam or Andrew, I don't want to kind of overcomplicate this, but if we look at the core number ex the claim of \$0.30 in the second quarter, you've laid out a lot of like small step change positives in every single segment and we're still looking at midpoints of 33% and 34% for the third quarter and the fourth quarter. I know there's the other income in 4Q, I know there's a seasonality in LTL, I know we've identified the tax rate, although your tax rate was quite high in the second quarter as well. So is there just, is this an element of conservatism on kind of not quite getting the true seasonality that you would typically get in September/October and just keeping a really low bar with the potential step change to 2025? Or do you feel like you really have line of sight on this is kind of, let's call it, really steady into year end with kind of a hope for 2025?

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

So, Jon, I hate ever calling our guidance conservative, right? I think this is how we—

Jon Chappell, Analyst, Evercore ISI

I don't think anyone's done that before.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Yeah. So I think this is the best indication of where the business is going to perform with the information that we have today. And again, we don't want to sit here and call the inflection. Again, we saw positive signs. As I mentioned earlier, we can't call it a trend yet, but we've seen this market move rapidly, both up and down, and typically we haven't been able to forecast that. So there's always the risk that it moves faster than we forecast, but right now our assumptions are that we have this steady improvement in the business and, as you said, we've made some step function changes in each of the different segments, which we're encouraged by but are nowhere near where they need to be, and based on what we're hearing from customers, based on the data that we're seeing from our businesses as well as third party, we believe that will be a consistent improvement throughout the rest of this year. Now could it be more volatile to that? Certainly. I think we've seen that in the past. We're just not in a position right now to try to forecast that.

Jon Chappell, Analyst, Evercore ISI

Okay. I understand. Thank you, Adam.

Operator

Your next question comes from the line of Eric Morgan from Barclays. Your line is now open.

Eric Morgan, Analyst, Barclays

Good afternoon. Thanks for taking my question. I guess I'll ask one on logistics, just the brokerage gross margin improving sequentially from 1Q to 2Q, can you just speak to some of the drivers there? Any shifts in power-only or some of this volume transfer with that asset-based business that had an impact? Just based on, you know, given what we're seeing in spot market, just curious if you could offer some color there. Thank you.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

So, Eric, I think that's probably largely driven from just pricing discipline. We're always managing the pricing dynamics of customers between our logistics business and our asset-based business and we try not to undercut each other unless it really makes sense in a certain market where one service offering would take the lead with the customer. And so, because we appreciate how much pricing flows to the bottom line, and in some cases would value that over just sheer volume, especially in logistics, that we've probably taken a more disciplined approach to maybe others in the market. And I think also the addition of the U.S. Xpress team has helped that. I mean they actually had a good logistics business. We had to make some adjustments on how it was staffed and the way that worked to help the gross margin flow to the bottom line to operating income, but they've been additive to that team and they've got some niche customers that they do really well with. And so we've helped them with some systems and the way they approach the market, but that team has helped improve our overall logistics capabilities and also the gross margin and profitability.

Eric Morgan, Analyst, Barclays

Thank you.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

All right. We'll do the last question here.

Operator

Thank you. Your last question comes from the line of Bruce Chan from Stifel. Your line is now open.

Bruce Chan, Analyst, Stifel

Good afternoon and thanks for the question here. Adam, I just wanted to follow up on some of the commentary around U.S. Xpress. You gave us some good color there already, but I want to make sure I'm understanding it properly. You said most of the opportunity there is self-help, and I would think there's still some juicy low-hanging fruit, but you also mentioned that the process in terms of finding the profit contribution in the back half and that would come with some help from the market. So is the idea there that U.S. Xpress will contribute if you have some market tailwinds but we could be close to another breakeven quarter a couple of quarters again if that doesn't materialize? I just, again, I want to make sure that I'm understanding that properly.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Sure. So I think what I was trying to say is the progress we made with U.S. Xpress up to today has been largely self-help, because there really hasn't been market support. It's been probably more of a headwind. Right? So I think we've made progress despite where the market is. And when we look at the back half of the year for U.S. Xpress, if seasonality plays out like we our forecasting for the rest of our business, I think U.S. Xpress would see the same benefits from that and would be a contributor, particularly in the fourth quarter more so than the third quarter as they start to enter into similar markets that Knight and that Swift participate in when you hit a fourth quarter with some seasonality. So yeah, I think we expect to make some continued progress. If the market is significantly different than forecasted, obviously that could change how they perform. I think when we see the inflection, you know, where it's more meaningful and contract rates are up in a more meaningful way, then that's when I believe U.S. Xpress will see meaningful improvement and really will start to close the gap to Knight and Swift and get closer to operating in the 80s, and that may start with high 80s and then low 80s or mid-80s and it gets back to that \$1 per share that we initially talked about in terms of accretion. It may take a little longer to get there given this down cycle has lasted longer than expected, but we certainly see that there's line of sight based on how that business is positioned and what we think the opportunities could be in a strengthening market.

Bruce Chan, Analyst, Stifel

Okay, great. Thanks for that clarification. That's helpful.

Adam Miller, Chief Executive Officer, Knight-Swift Transportation Holdings Inc.

Okay. All right. Well, that will conclude our call. Appreciate all the questions and everyone dialing in. And if we didn't get to your question, you can call us at 602-606-6349. Thanks, everyone.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.