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SNDR.N - Q4 2017 Schneider National Inc Earnings Call

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PRESENTATION

Operator

Greetings, and welcome to the Schneider National 2017 Fourth Quarter and Full Year Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Mr. Pat Costello, Senior Vice President, Investor Relations.

Pat Costello

Thank you, operator. Good evening, everyone, and thank you for joining our call. Thank you for your flexibility with our change to an evening call. We currently anticipate that our practice will remain to have our call in the morning, but an evening call worked out -- worked better this quarter.

By now, you should have received a copy of the earnings release for the company's fourth quarter 2017 results. If you do not have a copy, one is available on our website. Additionally, I would like to highlight a press release from Tuesday, announcing a 20% increase in the quarterly dividend to \$0.06. Joining me on the call today are Chris Lofgren, our Chief Executive Officer; Mark Rourke, our Chief Operating Officer; and Lori Lutey, our Chief Financial Officer.

Before we begin, I would like to remind you that some of the comments made on today's call, including our financial guidance, are forward-looking comments. These statements are subject to risks and uncertainties, including those described in the company's filings with the SEC. Our actual results may differ materially from those described during the call. In addition, any and all forward-looking statements are made as of today, and the company does not undertake to update any forward-looking statements based upon new circumstances or revised expectations.

Also, non-GAAP financial measures are discussed during this call and are reconciled to the most directly comparable GAAP measures in the tables attached to our press release.



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I would like -- I would now like to turn the call over to our CEO, Chris Lofgren. Chris?

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Thank you, Pat. Good evening. The fourth quarter played out consistent with our expectations regarding customer demand and supply of capacity. We saw strong performance from our network for-hire businesses as well as our Logistics business where these segments pivoted, responding to significant price volatility and capacity availability. Price in the quarter was strong across all aspects: contract, seasonal premiums and spot. Our Quest platform allowed us to be responsive to customer commitments while exercising choice to enhance our realized price in the quarter.

The net up in drivers throughout the third quarter and our portfolio of services allowed us to respond to growing customer volumes while also providing alternatives to truckload capacity, which was stretched during most of the fourth quarter. This can be seen particularly in the revenue growth and the earnings for our Intermodal and Logistics segments. We made significant investments in our First to Final Mile network in 2017 to deliver the transit times and service levels for the growing e-commerce sector. It will be incumbent upon us in 2018 to drive realized volumes across this fixed-cost infrastructure. We have a growing customer pipeline of notable e-tailers that should allow us to achieve the improving margins from this business. This too will be an area of intensive -- intense focus for us both in the first quarter and throughout the year.

In the annual guidance, the bottom and top of the range are defined by our views into net price, the difference between change in contract price minus the increases in driver-related costs necessary to have the fleet at planned capacity levels. We are on the front side of seeing the impact to the available capacity within the industry resulting from ELD enforcement. Additionally, both the availability of drivers and the recruiting cost and pay structure that could result from the flight to carriers already compliant with the ELD mandate is still early in the process. These dynamics will have significant impact into both the top and bottom line performance of the business throughout the year. We are optimistic looking forward and believe our commitment to safety, our portfolio of services and the Quest platform position us to favorably operate in this emerging environment.

I will now turn it over to Mark Rourke.

Mark Rourke - *Schneider National, Inc. - COO and EVP*

Thank you, Chris, and good evening, everyone. I'll offer a few general market observations before transitioning to segment specifics within Truckload, Intermodal and Logistics.

The market conditions throughout the quarter were robust with an especially acute peak period in the month of November. We attribute the demand and the supply tightening to be both a function of increased demand into a healthy economic market condition as well as a tightening of supply further compounded by the ELD mandate impacts.

The market robustness in the quarter is evidenced by nearly a threefold increase in daily order turn downs in our for-hire Truckload business as compared to a year ago and a 46% increase in the number of customers seeking spot capacity support from our truck brokerage services. Net price, as Chris mentioned, change in price minus change in driver-related expenses, continues its positive momentum in the network-based for-hire portions of our Truckload business and the Intermodal service offering.

Now a few more specifics in regards to Truckload. In the Truckload segment, revenue per truck per week, excluding fuel surcharge, improved 5.3% over Q4 of 2016. Most of the gain was in price, 4.4% of that 5.3%, and a remaining 0.9% was an increase in productivity. Price improvement is a combination of contract both in and out of cycle, choice-driven upgrade and seasonal premiums.

The network-based for-hire quadrants realized the most improvement. The for-hire standard, our largest segment within Truckload, increased revenue per truck per week, again excluding fuel surcharge, 7.6% over the same period in 2016, and 9.6% sequentially as compared to Q3 of '17. 5% of that gain was price driven and the remaining 2.6% productivity driven. Average tractor count was down slightly below 100 units year-over-year and essentially flat with Q3.



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Dedicated specialty quadrant experienced the largest increase in average truck count at over 16% growth in Q4 of '17, as compared to Q4 of '16. New business start-up inefficiency impacts and the more limited exercise of choice options available in dedicated configurations resulted in a 1% erosion in revenue per truck per week in Q4 2017 versus the same period in 2016. Dedicated contract configurations in general are more predictable revenue streams, but they do respond slower to change in inflationary cost pressures. We expect to continue to make progress over price improvement over the next 2 quarters as renewals occur.

We noted last quarter that our First to Final Mile offering's time line to achieve targeted margins will be measured in quarters and not months, and margin performance was a drag on the Truckload's average segment performance in the quarter as the national less than full load network operates in a more fixed cost nature than our full-load offerings. However, order volume growth with new and existing customers will drive higher incremental contribution margins as the current network scales over the -- 2018.

Let's transition to Intermodal. Our contribution versus price-focused assessment of freight led to an improved basket of efficient freight, resulting in a year-over-year growth in order volume of 4% on 1% less containers despite slower train speeds and an 8% growth in longer length of haul, transcon order count. The Intermodal segment delivered an excellent container and dray asset productivity quarter. We are now fully fielded in the owned chassis program and are enjoying the low operating costs associated with the change. We grew the company dray fleet throughout 2017 with a minimal increase in tractor count. And that solid company dray execution performance mitigated the need to use higher levels of less reliable and costly third-party dray resources. In fact, percent of orders executed on a company dray increased 120 basis points year-over-year in Q4.

And for the first time in 2017, revenue per order, excluding fuel surcharge revenues, was up over the same period from a year ago by 1.5% and sequentially up 7% from Q3 of 2017. Furthermore, if you consider the 6.6 million of duplicate chassis rental cost experienced within the quarter, Intermodal achieved a record operating ratio of 86.2%.

And finally, our Logistics segment experienced revenue growth of 26% year-over-year as brokerage percent of revenue grew to 77% of our Logistics revenues. Accelerated order volume and net revenue per order growth of 34% in a capacity-constrained market enabled a 5.4% segment margin, improving 80 basis points as compared to the same period in 2016. The Logistics segment is highly synergistic with Truckload and Intermodal to capture more of our customers' freight coverage needs.

And with that, I'll turn it over to Lori to cover more of the summary of our financial metrics.

Lori Lutey - *Schneider National, Inc. - CFO and EVP*

Thank you, Mark. Now on to the results for the fourth quarter and for the full year of 2017.

Enterprise operating revenue in the fourth quarter increased 11% year-over-year to \$1.2 billion, while revenue, excluding fuel surcharge, increased 10% to \$1.1 billion. This was due to improved market conditions and the larger driver fleet as a result of recruiting efforts during the third quarter. For the full year, enterprise revenue increased 8.4% and after adjusting for fuel surcharge revenues, increased 6.5%.

Enterprise income from operations in the fourth quarter of 2017 was \$94 million, an increase of 7% compared to the fourth quarter of 2016. Adjusted enterprise income from operations was \$100 million, an increase of 12% compared to fourth quarter of 2016. This was primarily driven by improved price and productivity experienced throughout the quarter, as Mark and Chris have discussed. For the full year, enterprise income from operations decreased 3.5% and 3.9% on a GAAP and an adjusted basis, respectively.

Following the recent tax reform, the company reduced its net deferred tax liability by \$230 million in the fourth quarter due to the revaluing of the deferred tax balances at the newly enacted 21% federal income tax rate. Before the impact of the Act, the effective tax rate in the fourth quarter of 2017 was 39.6%. Going forward, we anticipate a tax rate between 25% and 26%.



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As a result, net income in the fourth quarter was \$284 million, or \$1.60 per diluted share, as compared to \$48 million and \$0.30 per diluted share a year ago. On an adjusted basis, EPS in the fourth quarter of 2017 was \$0.33, which includes the impact of increased share count from the recent IPO estimated at \$0.04 per share. For the full year, diluted earnings per share was \$2.28, while adjusted diluted earnings per share was \$0.94.

Adjusted EBITDA for the quarter was \$172 million, an increase of 9% compared to the fourth quarter of 2016. For the full year, adjusted EBITDA of \$561 million was relatively flat compared to \$559 million in 2016.

Operating ratio in the fourth quarter increased 30 basis points year-over-year to 92.1% and improved 20 basis points on an adjusted basis to 90.8%. Adjusted operating ratio sequentially improved 240 basis points compared to the third quarter of 2017.

Now turning to our results from a segment perspective. In our Truckload segment, the fourth quarter reported revenue, excluding fuel surcharge, of \$571 million, a growth rate of 6%, with an operating income of \$63 million and an OR of 88.9%. For the full year, in our Truckload segment, revenue excluding fuel surcharge was \$2.2 billion, and operating income was \$196.2 million.

Turning to our Intermodal segment. In the fourth quarter, we reported revenue of \$209 million with an operating income of \$22 million and

(technical difficulty)

in the operating ratio of 89.3% before adjusting for the chassis implementation. For the full year, Intermodal revenue was \$780 million, and operating income was \$52 million.

Finally, within our Logistics segment. In the fourth quarter, we reported revenue of \$250 million, with an operating income of \$13 million and an OR of 94.6%. For the full year, revenue was \$834 million, and operating income was \$34 million.

As of December 31, 2017, Schneider had a total of \$441 million outstanding on various debt instruments compared to \$699 million as of the end of December 2016. Given our positive free cash flow, we decided to utilize the IPO proceeds to repay all of the debt that we could without incurring prepayment penalties.

On December 31, 2017, our cash and cash equivalents totaled \$239 million compared to \$131 million at the end of December 2016. The company's net increase in cash and cash equivalents of \$108 million was primarily due to the combination of proceeds from the IPO and an increase in free cash flow partially offset by debt repayment. In 2017, free cash flow increased \$61 million compared to 2016.

Lastly, we are providing guidance for 2018 that takes into account the impact from the tax reform and net price, as Chris discussed earlier. We anticipate full year 2018 adjusted diluted earnings per share to be in the range of \$1.32 to \$1.44. The midpoint of this guidance represents a 23% increase in operating earnings year-over-year.

I recognize that you did not have a long history with the company and how our portfolio of services and diverse customer base perform across the quarters. We typically have more of our earnings in the second half of the year, with the first quarter typically being our lowest earnings quarter.

As it relates to our capital expenditures, we anticipate a range similar to 2017 of \$325 million to \$375 million. The key driver for 2018 includes growth capital to support our growing Intermodal business as well as an increase in tech spend to support upgrades and telematics and continued development of our Quest platform. Essentially, growth capital will replace our 2017 investment in chassis.

With that, I'll now turn the call back to Chris.

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Thank you, Lori. Before opening up the call, I want to take a minute to recognize Lori's upcoming retirement that was announced earlier in the quarter. Lori has made incredible contributions to Schneider over the past 7 years, from the dynamic changes we've driven into the performance



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of the business to helping lead the enterprise to becoming a publicly traded company. She's been a tremendous asset to me professionally and personally. I'm grateful for her commitment, her loyalty and support in bridging the transition to finding her replacement. And I wish her all of life's greatest blessings as she starts this new phase of her life. I will miss her.

Operator, we would now like to open the call up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Ravi Shanker of Morgan Stanley.

Ravi Shanker - *Morgan Stanley, Research Division - Executive Director*

Chris, I think you were the first trucking CEO to speak of 2018 in 2004, 2005 terms rather than 2014 terms. Can you just give us a sense of what you're thinking right now? We heard another TL the other day talk about potential low double-digit pricing for next year. How would you frame the bull and bear case in pricing?

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Well, Ravi, I think that if we look kind of backwards at Q4 and some of the work that we have done with customers on sort of out cycle adjustments but then also the things that we've just seen in the marketplace, we saw kind of about a 5% price improvement. As we come into January, we see continued pressure up. So if I was to pick on the price aspect alone, I think we're probably trending a little bit more towards the 2004 time frame. We'll see how far that pushes as we get into the first quarter and closer to that April 1 date for the mandate enforcement.

Ravi Shanker - *Morgan Stanley, Research Division - Executive Director*

Got it, understood. And while I have you, you guys also put out a press release this quarter -- last quarter talking about the Tesla trucks that you guys have ordered. Can you or Mark just give us a little bit of a summary on what your thinking was in placing that order, what kind of testing you've done, what kind of relationship you have with them and where you see that going over time?

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Mark, why don't you take that one?

Mark Rourke - *Schneider National, Inc. - COO and EVP*

Sure. Thanks, Ravi. We haven't done any material field testing. We've certainly been around the product and around the engineering components of it. And certainly, based upon the promise of materially simpler mechanical performance of that with electronic versus the diesel componentry, we're very bullish not only the acceptance from the driver community but the overall performance and the cost savings associated with operation. So obviously, we've got to get to a position that they can build scale and that we can deliver on scale and then certainly some additional questions as it relates to the charging infrastructure and the range and -- but certainly, the things that were discussed and the pricing point and what may be on the offering there on the battery range, very, very exciting stuff.



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Operator

Our next question comes from Tom Wadewitz of UBS

Thomas Richard Wadewitz - *UBS Investment Bank, Research Division - MD and Senior Analyst*

And I know -- I think I've said this. We talked about this before, Lori, but just say again, wish you the best in retirement. Let's see. On the Truckload business -- so you had -- I mean, you had really strong performance in Intermodal and Logistics. Truckload, I would have thought that more of the maybe strength in spot market and some repricing on contract would have come through just in terms of the margin. I know you've got some headwind from the last mile business. But I wanted to see if you could give some thoughts on what's your assumption on Truckload margin and your guidance in 2018, and how you think that progression might play out in terms of margin expansion as you look through the year in truck.

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Mark? Mark's dying to answer this question, I think. I'll come in behind him.

Mark Rourke - *Schneider National, Inc. - COO and EVP*

I'm not sure that's the description, but Thomas, let me just maybe comment on the margin and the fourth quarter approach. If you certainly look at our most responsive segments to the market relative to a pricing movement would be in our for-hire segments, where they would be Intermodal, our specialty for-hire or our standard for-hire. And you've seen pretty solid movement in revenue per truck per week, which is associated both with price and taking some of the special opportunities that existed there. Now we largely do that. It offers -- when we have to cover additional volume, that's not our typical year-round volume. We do put special pricing against that but it's generally with our contract customers, not just transactional spot with 3PLs and otherwise. So that's generally how we approach that, and I think we've seen some solid progress there. There is some bit of lag relative to our portfolio and not -- and a good portion -- not a good portion but a solid portion of our dedicated configurations, which has a bit of a lag as we get a chance to go in and adjust to the current conditions relative to the renewals. And so that's where we saw both on a revenue per truck per week and some margin compression on a portion of that dedicated portfolio. And then while we're not adding to the cost and infrastructure as it relates to the Final Mile business, we think we're well positioned. But additional volume there, as we get into 2018, will be a much higher incremental margin opportunity per order based upon us being prepared to take that additional volume without putting a great deal of additional cost against it. So that's how I would characterize the fourth quarter. And as Chris mentioned, we're seeing additional movement both in cycle and out of cycle here as we get into the 2018 time frame. And I wouldn't really offer any really additional guidance than Chris offered to the initial question.

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Tom, maybe just a follow-on on that is that while we have a sizable dedicated contract business, it isn't the largest percentage of that. But those contracts tend to move a little bit slower. And given the pressures that came relative to driver cost, they've moved too slow. And we certainly want to be conscious of the role that those fleets play with our customers. We have to be in some pretty forward-thinking discussions particularly as these things renew and a recognition of where the driver costs are going to go. The other thing that does happen in environments like we saw in the fourth quarter is in some cases, because of access to that equipment and those drivers, you'll see some incrementally higher cost come to the fleet. And so those have to be addressed. Many of them have been, and it's front on our agenda here as we started up the year.

Thomas Richard Wadewitz - *UBS Investment Bank, Research Division - MD and Senior Analyst*

Okay. So that -- I mean, it makes sense. It sounds like it's a function of timing where as you get more of the business repriced, then we would see some momentum develop on the margin improvement on a year-over-year basis, if I understand your responses right. What about what you have in your guidance assumption? It sounds like maybe you don't want to give a specific margin level on Truckload within your earnings guidance, but



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I mean, ballpark, are you assuming 100 basis points in Truckload OR in 2018? Is it a lot less than that? It seems like you would set up that if this is like '04 that you could get more than 100. Maybe you could get 200, something like that. So just any comments in what's in your guidance in terms of OR improving on truck.

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Well, Tom, that was a good try. We don't give guidance at that level. But what I think I can kind of help you in terms of doing what I know you're going to go away and do is I think the gross margin opportunity clearly is there. And as we thought about our guidance, we really tried to understand the dynamics that are going to occur relative to access to drivers. We're in a full employment economy. We have seen the start of some things. I mean, every week, we're seeing people leaving carriers that have not become ELD-compliant yet and -- concerned that -- can that business operate and function when those -- when that constraint hits it, what that's going to look like, how mobile that group of drivers could become, is one of the things that we're spending a lot of time trying to understand. And that's going to tell us an awful lot about what net price looks like. And so as we started our budget planning, there was a lot of work really done at that level. And of course, the place where that plays out the most for us is in the Truckload business. But there will be improving margins in that business as a result of the price we're going to see as a result of contracts, particularly dedicated contracts, that will renew and that we'll need to adjust going forward. So I would just kind of start at the bookends. Think about net price and some of the assumptions that would be there more on what's the driver acquisition cost. And in the end, we're also looking at what growth in the fleet we might consider depending upon the cost of driver acquisition and the role that, that could play. So those would be the places, I guess, I would direct you to.

Thomas Richard Wadewitz - *UBS Investment Bank, Research Division - MD and Senior Analyst*

Okay, that makes sense.

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Did that help?

Thomas Richard Wadewitz - *UBS Investment Bank, Research Division - MD and Senior Analyst*

Yes, yes, that helps, yes.

Operator

Our next question comes from Allison Landry of Credit Suisse.

Allison M. Landry - *Crédit Suisse AG, Research Division - Director*

I wanted to ask about Intermodal and specifically the margins there. I mean, obviously, you've had the conversion of the chassis. That is a benefit. But just curious, number one, are you experiencing any derivative impact from the rail service issues in either the East or the West? And could you comment on the -- if there's any profitability differences between the East and the West and if that had anything to do with the improved margins in the quarter?

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Sure, Allison. There -- the easy part about trying to understand the impact of the chassis conversion was just the difference in ownership cost from leasing it to owning it. And that was real easy, and that was factored into a lot of what we put into our plans last year. I think we had a belief just



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given the friction costs, as we tend to refer to them, as we got further and further into the year and frankly very much in the fourth quarter, we just saw execution benefits in terms of productivity of the drivers, productivity on the street and of turning the equipment. And that was a good part of it. I think Mark can comment even more on that and would like to. And then if there is different dynamics between the East and the West and the transcon and then we worked pretty hard to try to capture the cost and the time on the train versus time on the street and the general dynamics of -- in that. So we're trying to make sure that the appropriate returns are throughout the network and take into account the dynamics on each of those parts. So I think we're getting better at that, and I think that certainly was a part of how we managed the network that led to the results in the fourth quarter. But Mark, maybe you'd like to fill in on that.

Mark Rourke - *Schneider National, Inc. - COO and EVP*

Yes. The Intermodal team just did a terrific job of managing the productivity of the assets. And certainly Allison, the train speeds did have an impact. We believe if we could have had similar rail fluidity in Q4 as we did in Q2, we probably could have done another 3,000 orders effectively across the network despite being down slightly on containers just due to the effectiveness of -- on the street and the productivity. But we also, through the platform, have managed our network to minimize dwell time between loads and putting a great deal of emphasis around the efficiency of the freight, not just the price of the freight but the efficiencies so that we can get that box turned and get it back moving on another revenue-producing load. And so I would characterize the quarter is just the coming together of that solid revenue management network plan and just our professional driving force incredibly productive. We put about 200 more dray drivers into our network in the year with very minimal increase in tractor count. And we were able then to avoid the margin-eroding impacts of having to go out into this market with additional third-party capacity. And so even with the growth or the order growth and slowdown in the network a bit, we still put more percentage, 120 basis points year-over-year increase, on our orange company dray than going out and playing in the third-party world. So those were the key drivers of just a pretty solid quarter.

Allison M. Landry - *Crédit Suisse AG, Research Division - Director*

Okay. And then -- so a follow-up question. As we think about the Quest platform and the ability for optimal freight selection that you've been talking about for some time, how much do you think that, that contributed to the better-than-expected earnings in the quarter? And is there a way for us to quantify this or see this in the numbers?

Mark Rourke - *Schneider National, Inc. - COO and EVP*

I think the best way to quantify and see that is our best proxy for contribution, which is the focus of our efforts on freight selection and guidance to our sales and customer-facing groups, centers around those areas where it's most prevalent, which is in the for-hire, specialty for-hire standard and then our Intermodal network and then Logistics because that's on the buy/sell side of that. It has a bit less impact in those locations or those configurations where we're not playing in the choice as directly, which tends to be our dedicated configurations around our Truckload quadrant. So when you look at revenue per truck per week improvements both sequentially and year-over-year, that's at the heart of what we're trying to do relative to freight optimization and selection in those configurations.

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Allison, maybe if I can just add to Mark's response. A lot of the way that we have set up the business is that we have pretty substantial relationships through the bidding process and lane opportunities and where a number of truckload carriers will really kind of shift their emphasis into the spot. Our -- probably comes -- our company probably goes at this more in terms of exercising choice. So as more opportunities are there, Quest allows us to look at where those opportunities are, not just what we're taking today but what we project will be out in markets, continuing to manage how the network flows but do it more within the contract relations that we've got. And then clearly, in this time of year particularly as capacity tightens, customers are willing to offer premiums against those rates that factor into how we think about the basket of freight that we're going to operate with and choose from. And that's across all of those for-hire businesses. So while our spot percentage, typical spot third-party brokered kinds of things doesn't go up a lot, we have opportunities to pursue lanes that may not have been offered to us because they were given to somebody else in the year and then at this point, they can't service them. So what Quest lets us do is it lets us understand the impacts of every load



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we're given an opportunity to look at, how it fits within the network today, how it fits into the network that we project out in the future and then exercise choice against that, which essentially gives us higher realized price. So we think we have a nice opportunity in this environment. It certainly helped us on the downturn, as a lot of you had noted. Those same kinds of attributes come to play as we shift and look at the upturn.

Operator

Our next question comes from Chris Wetherbee of Citi.

Christian F. Wetherbee - Citigroup Inc, Research Division - VP

I wanted to ask about net price, it's an interesting metric. And I think on the last call, you had suggested it turned positive in September and kind of continued on into the early part of the fourth quarter, kind of like you maintained that. But if could you give us some sense of sort of the progression of that over the course of the fourth quarter and maybe a little bit of a forward-look into the first quarter and your expectation for 2018, I think that would be helpful just to try to size it up relative to some of the cost headwinds you're seeing.

Christopher B. Lofgren - Schneider National, Inc. - CEO, President and Director

Chris, certainly, we saw net price continue to move up as we moved through the quarter. Again, net price is this, I guess, nomenclature that we talk about internally and some of the dynamics that are there. Factored into that for us through the quarter is just this natural reaction that as you get into the back half of December, it's challenging to see a lot of new drivers coming in to get trained to join our company. And so you'll start to see that some of the recruiting costs stay aloft, which obviously helps net price. And we've clearly done a bunch of work at that point in time in terms of contract rate increases if we were going to attempt to go in and get those things done. So we saw improving net price. And in some cases, the work that we did in the third quarter to position the fleet said we had a different level of recruiting that we needed to do in this high-demand fourth quarter, which was really what our plan was. And then it tailed off a little bit, and the fleet tailed off a little bit as we got towards the back half of December. And all of those things will factor into net price. I think what is more important looking forward, again, is what's going to happen as we're starting to see some impacts of the ELD enforcement is -- are these drivers going to be -- first of all, are they going to be quality drivers who can operate under our more disciplined systems? And are -- do they have a desire to come in and work for a company like us and a number of our competitors? And what will that do in terms of recruiting expenses? Whereas if they tend to leave the industry and go to work in some of these jobs that are becoming available, whether that's construction or a local construction job, driving truck, that's going to be -- to me, that's the one thing that we're looking at. It's going to tell us an awful lot of what we might face not on the gross price side but on the pressure to make sure that we have the appropriately sized fleet both given the equipment we have and then what might emerge in the back half of the year in terms of opportunities. Mark, I don't -- he says he's got nothing to add to that.

Christian F. Wetherbee - Citigroup Inc, Research Division - VP

That was a helpful and a comprehensive answer. So I appreciate that. I guess just a quick follow-up on the Intermodal side, just kind of coming back to that and trying to understand maybe the set-up and the timing of the improvement. You talked about productivity and the turns on the fleet in the fourth quarter and allowed to get these really solid margins. As you look forward into 2018 and you think about some of the pressures you may be seeing from a rail pricing perspective and maybe from a capacity perspective, how much more sort of productivity do you think is out there in terms of opportunity for the segment? I just want to get a sense of -- is there more yet to come there?

Mark Rourke - Schneider National, Inc. - COO and EVP

Sure. This is Mark. And we do believe that we have an excellent execution product as truck capacity is tightening, and we expect it to tighten further. That gives us a growth opportunity. And so our intention -- and as Lori mentioned, some of the CapEx will be to put additional boxes, chassis and tractor, dray tractors into our Intermodal offering in 2018. So -- and so we're confident that the market will bear that and our execution platform will be valuable to the customer community to take advantage of the tightening tractor market. So -- and we're seeing really, as we sit here in



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January, still a very robust demand condition not as typical in January when you look over a long historical period that we're still seeing quite a bit of opportunities in the Intermodal space and still clicking along at a nice pace. So this gives us more confidence relative to that growth capital that we're talking about.

Operator

Our next question comes from Ken Hoexter of Merrill Lynch.

Kenneth Scott Hoexter - *BofA Merrill Lynch, Research Division - MD and Co-Head of the Industrials*

Chris, Pat, thanks for moving the call away from this morning. That is appreciated. And Lori, thank you for all your help through the IPO and since and good luck. Chris or Mark, I guess just your -- I guess coming back to the driver pay, maybe a little bit more thoughts. You noted in the release your -- you hope to recover the driver investments already incurred in 2017, and those you expect to make in 2018. So are you already looking at a certain pace of driver pay increase? And then with that, you mentioned you -- your pricing. Is that already taking into consideration to cover those increased costs as you work to renegotiate the contracts now?

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Ken, this is Chris. I'll just take a quick, kind of 50,000-foot at this and then turn it to Mark. But I think the point that you made, yes, we put a lot of expense into the driver. And frankly, given the pressures on price that we carried into the first half of the year, it took until just about September to cross over into what we would have referred to as net positive price. And that's continued, and it needs to continue in order to make sure that we're generating appropriate returns. I think the market is going to give us pricing opportunities. And there's no doubt that we will continue to have to share that with our drivers as we move into the future of this year. So we're going to -- I mean, this is something -- it's -- we compete for drivers just like we compete for freight with all of our competitors. And we look very closely at what we need to do. We also look at where would we like to have these great professional drivers that work for us. And again, part of the thing that we tell people is it's how do we pick freight so that we keep them moving because the end, it's not just the rate per mile. It's -- ultimately, it's the W-2 income that they're able to bring home to their families that is important. So that's another place where in an environment like this, we can exercise choice. So it's choice on the base cost per mile or the rate per mile that's in there but it's accessorial, some that we share with the driver. But it's also productivity that we experience on that load and then as well as the markets that it puts it into. So we're factoring all of those kinds of things into how we think about what we've got to do in terms of pay increases for our drivers. And pay is a good thing. Oftentimes, these signing bonuses which, in tight times, become important but those are not really systemic things that, in our mind, position where we'd like things to be long term. So we're going to take incremental pay. We've done a lot of work, frankly, to -- in '17. So we don't feel like we're way off. But I think just the pressures that come from having the best drivers in the industry will continue to push that on us. So I think that, yes -- Mark says that's it. It's how fast you run the trucks and still be safe. This thing is so nuanced, Ken, that the amount of sophistication that gets applied to it is pretty intense, but I think the organization is tuned into it. And we ripple that back pretty quickly to the sales force to understand where do things have to be.

Kenneth Scott Hoexter - *BofA Merrill Lynch, Research Division - MD and Co-Head of the Industrials*

Great, I appreciate that. And you're letting Mark off easy here. So Lori, if I can just kind of follow up on CapEx. You talked about keeping it high even as the chassis cost goes away. Maybe you can talk about, are you aiming to bring down the average age of the fleet? What are you looking to do in terms of capital? And then also, you mentioned the used truck market was stable, had a decent gain on sale in the quarter. Is that selling more equipment in anticipation of keeping the CapEx high?

Lori Lutey - *Schneider National, Inc. - CFO and EVP*

Okay. On the -- Ken, on the CapEx, the way I would look at our CapEx spend is really going forward, the chassis will be replaced with growth capital really to support Intermodal containers, chassis and some additional tractors in our Intermodal business. Then there's also some spend in there



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related to a year-over-year increase in tech spend for upgrades in the telematics and more improvements to our Quest platform. So our replacement strategy really -- our replacement capital really is pretty relatively flat year-over-year. It's the increase, I would look at it, that your chassis are being replaced by growth capital. Then in terms of the used equipment market, Mark, would you like to address that? Because I don't think we commented on that.

Mark Rourke - *Schneider National, Inc. - COO and EVP*

Yes, I guess the -- I think Ken, your characterization of it being stable is probably an appropriate one. We certainly had less gain on sale this fourth quarter than a year ago. And then year-over-year, it was about \$9.5 million less, and predominance of that is in Truckload. So while we're keeping up and getting things out of the fleet, it's not due to really a big change in age of fleet. And we're doing so at a less gain per unit than a year ago, but it certainly stabilized the back half of the year.

Operator

Our next question comes from Scott Group of Wolfe Research.

Scott H. Group - *Wolfe Research, LLC - MD & Senior Transportation Analyst*

So I know there had been a bunch of questions on price. I don't know that I've heard any numbers yet maybe. Can you share what are your gross pricing expectations for the year? And then what is the driver pay inflation that you expect this year?

Mark Rourke - *Schneider National, Inc. - COO and EVP*

Yes, we haven't given a specific number on that, Scott. I'd tell you what we did here in the fourth quarter, about 5%. And again, this is mostly centered around the for-hire space. We've seen an improvement in that so far in the month of January, and we would expect that we'll continue to see improvement in the price line throughout the year. We just haven't put a perfect bow and communication on what exactly that is, but we're increasingly more confident. And really, the standpoint we're having success, getting some out-of-cycle increases to bridge to procurement events so that -- again, this is not going to be in our view, perhaps just a single bite at the apple. And that will really be a condition of the market and the condition of the driver community. So we're just preparing our customer base and we're preparing our organization to be nimble. And this may be a multiple-round effort, not just a single bid season.

Scott H. Group - *Wolfe Research, LLC - MD & Senior Transportation Analyst*

Okay. Can you say, with the upcoming February driver pay increase, what sort of the effective driver pay increase is?

Mark Rourke - *Schneider National, Inc. - COO and EVP*

You're referencing?

Scott H. Group - *Wolfe Research, LLC - MD & Senior Transportation Analyst*

I think you guys are doing like a driver pay increase, February 11.



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Mark Rourke - *Schneider National, Inc. - COO and EVP*

Yes, we're doing some. Again, none of these are across the board. That's in our network business and our configurations that are running in our regular route, over-the-road fleet. And that -- it will be targeted by -- and we'll continue to look at those by work configurations, geography. That one is centered almost exclusively around our van, over-the-road for-hire fleet.

Scott H. Group - *Wolfe Research, LLC - MD & Senior Transportation Analyst*

Okay. And then one -- just last one. I know there had been a few questions on Intermodal margins. But you guys were 300 basis points better than Hunt this quarter, which is sort of remarkable. Do you think that low teens Intermodal margins are sustainable? And if so, do you use that as an opportunity to start taking significant amounts of share?

Mark Rourke - *Schneider National, Inc. - COO and EVP*

Well, we're very proud and very pleased with the quarter, Scott. There's no doubt. And certainly, our Intermodal offering, particularly during the last 4 months or so of the year, does have a bit more of any import retail slant to it. And so our transcon business grew about 8%, which was the first time in some time that it grew at a faster rate than the eastern part of the network. And I think it's just a reflection of the health of the economy and the import sector. And so we do get some lift in the fourth quarter associated with that phenomenon. But again, we think we're well positioned. We think we're running a -- we're sweating our assets pretty heavily right now. That's why we believe we can grow the business with additional containers and still do so at very attractive returns. And so it will be our intent to continue to do the things that we're doing. And I think the market with the alternative to trucks being precious, Intermodal being a top, obviously, consideration there, that we're going to be and be -- remain bullish on Intermodal.

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Scott, I think the other thing is that we have to be very mindful of that tremendous competitor that we have. And I don't know that given our size relative to them and to other competitors that we have that it makes just a huge sense for us to try to play a market share game where we can create value, where we can get paid for that value. We're delighted to do that where we can grow and do that. We're delighted to grow and do that. But we're just not in a position of trying to simply say, how do we go take share by playing a price game. We're going to run this business the way that we've run it and we're going to compete really hard. And there is a notable competitor out there, but we are pleased with how we have been able to change the execution of that business without a doubt. And it's been with a lot of work. It's leveraging the abilities that we have with the Quest platform to manage a very, very good network to understand how productivity factors into that network and the ability, I think, with these chassis and the way we've positioned the equipment in this business to run a good, good business that can service the customers really well. And that's what we're going to go and do. So I don't think you should look to us to essentially play a market share grab game.

Operator

Our next question comes from Brian Ossenbeck of JPMorgan.

Brian Patrick Ossenbeck - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

Just wanted to go back to the First to Final Mile build-out. Last quarter, you said you're working through some additions. And you said it's also going to be a multi-quarter event until that starts to turn around. So it seemed like you're referencing some density, getting some volume now as the next sort of steps. Last quarter, I think it was getting first and middle mile sorted out. So if you can just step back and give us an update on where that is right now and where you think it will head throughout the year.



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Mark Rourke - *Schneider National, Inc. - COO and EVP*

Great. Thank you, Brian, for the question. And as I think about the network, we do believe we have our national LTL -- excuse me, First to Final Mile network solidified. And as we've transitioned from more of a -- from a B2B to a B2C configuration to address the e-retailer market, we've had to do some things to be more nimble relative to our transit schedules. And we've had a 25% reduction in our average transit nationally as part of building out the network that we did in '17. And now we believe we're just in the place of getting the scale, as you mentioned, to run across that network because it's more of a fixed cost setup than our typical full-load offerings. And so we are running it in a very fluid fashion. We're executing well. And there's not generally a lot of change around consumer decisions on customers in the fourth quarter, as everyone had battened down the hatches. And so that relief to make some changes -- customers to make some changes are much more prevalent here in the first quarter. And it's our intent then just to place additional volume against that. And then that additional volume comes at a much higher incremental contribution margin as -- against that fixed cost space. So executing well now, let's get some more volume running through our machine.

Brian Patrick Ossenbeck - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

Okay. Is any of the growth capital going towards that investment or you're pretty much pretty well built out?

Mark Rourke - *Schneider National, Inc. - COO and EVP*

Certainly, some of the tech investments that Lori mentioned will be applied here. But I think from an -- overall, we're in a bit of a growth mode there on -- as large as the first mile element gets. But mostly in the replacement space, we think we have the capacity to do more, and that's why it's focused on scale.

Brian Patrick Ossenbeck - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

Okay, great. And if you could just add some color to the comments made about the ELD tightness, if you're seeing it in specific markets or veins or if it's just starting to be more gradual across the entire network.

Mark Rourke - *Schneider National, Inc. - COO and EVP*

You bet. I guess, I'll frame the ELD feedback as we are seeing changes in our brokerage carrier base and -- which is much more aligned to the small carrier community. And so we have seen a notable difference. And as you could question a little bit, we ran into weather right about that time with busy season. But it's now here -- we sit here at the end of January and we've seen a notable difference in what length of haul that carriers used to be interested in, that 600 to 700 mile, which they'd like to try to do, I'm assuming at this juncture, in a day and change that. And so that's a much harder length of haul band to cover across the board in our -- both our outsourced Logistics and our brokerage Logistics model and the interest in the carrier community much more in the 300 to 400 mile where they can get more done. We're noticing a big difference in hours of service discussion with our freight sellers. And so there's no doubt that there's been a behavior change and been an awakening, I think, relative to what is possible and what's different that they have to approach in their business model. And again, I think that's in advance of some that haven't really made those adjustments probably until we get to this hard enforcement. So we're certainly seeing it and seeing it on the higher cost relative to carrier cost in those same models, which requires us to be incredibly nimble as it relates to how we pass that on to our customer community.

Operator

Our next question comes from Ben Hartford of Robert W. Baird.



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Benjamin John Hartford - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Mark, maybe just turning to brokerage real quick, the volume growth in the quarter of almost 17%, obviously, the spot market was tight. But you'd -- Chris had mentioned kind of the parallels to '04, '05. The markets changed a bit. And you guys obviously have Quest in the portfolio now. So when you think about the approach to '18, how sustainable is a 10%, 15%-plus type brokerage volume growth number accounting for the spot market as it is right now? But the approach to bid, is it an opportunity to be able to leverage some of the assets and focus and kind of sustainably drive very healthy brokerage volume growth this year?

Mark Rourke - *Schneider National, Inc. - COO and EVP*

I think so, Ben. I think a couple of things here. It's certainly a benefit to be part of the Schneider portfolio, and there is a lot of synergies between our various segments and service offerings that certainly we get access to and -- that our brokerage business then has a chance to take additional volume in support of our customer needs. We can make it easier on a customer to cover across multiple modes. And we certainly saw that in the fourth quarter. I think the demand level is going to be there. Certainly, the carrier costing is in a bit of flux right now. We have to make sure we're nimble enough relative to our spot versus contract and our ability with our technology, which we did invest a good deal of enhanced decision support so that we could be more timely to the market changes that were occurring. But it was a volatile period. We had more large losses on loads and more large gains in the fourth quarter, and we're continuing on those tails to make sure we can minimize the loss condition and maximize the net revenue per order. But we did see a pretty significant expansion of that in the fourth quarter. We're seeing some of those same trends continue here into January. But the brokerage model does seem to do well in volatile market periods and we expect to be in a volatile period here for 2018.

Benjamin John Hartford - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. And then Chris, in 2018, does the window begin to open up for acquisitions? You obviously have the IPO out of the way and the 2 final -- First to Final Mile offering platform deals done and integrated. So at what point in time do you start to more aggressively evaluate acquisitions?

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Well, it does take time and energy to find an acquisition and do an acquisition. And once you do them, there's always heavy lifting and those kinds of things you may not have seen as you went through diligence. I think we really are in a position now to try to accelerate forward, grow that business. We continue to believe that, that First to Final Mile will be a big growth vehicle for the company going forward. But we have a strong balance sheet and we're going to continue to look for opportunities. We told you and everyone on the road show that we would look for acquisitions that would get us new customers, that would get us new capabilities, that had resiliency and sustainability. So in the specialty areas, we didn't stop looking but we didn't probably look as hard. And that's something that we are going to get energized back up. And when the right opportunity comes, we're in a position to do it and we will. But it's kind of one of those things we say that we mustn't hurry. We don't have time for that because nothing can slow us down other than just not doing one of those right. So that's kind of our viewpoint towards it. It will be interesting to see what comes available. But what we're not going to do is go out there and purchase a company that didn't make the investments in the ELD that can't operate and we're just trying to purchase assets. We want to build and purchase customers and capabilities and growth opportunities where we're not today. So that's how we're going to think about it.

Operator

Our next question comes from Todd Fowler of KeyBanc Capital Markets.

Todd Clark Fowler - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

I'm guessing -- or I understand that you probably don't want to get too granular on how the earnings cadence is going to be from a quarterly standpoint. But Lori, you had some comments in your prepared remarks about earnings being more weighted towards the back half of the year.



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Are there any parameters you can give us as to how we should think about 1Q relative to 4Q or the first half of the year as a percent of overall EBIT just from a modeling perspective?

Lori Lutey - *Schneider National, Inc. - CFO and EVP*

Yes. I tried to provide some guidance, but we're really not going to be giving quarterly guidance. So it's harder to provide much more than I have. Chris, would you have any other...

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Todd, I guess what -- sitting where you're sitting, and I appreciate what you're trying to do, I think if you go -- and you can piece some further history just given we've been out now and numbers which bring the quarters to bear. So I think though that's important work and that will give you some insights, I think if you look out at some of the materials that are there relative to customer segmentation and where we play and -- that will help. But again, we are -- just given our orientation with retailers and particularly now e-tailers and consumer products, those kinds of things, it's always been a very, very strong second half. And frankly, the fourth quarters tend to be strong particularly in tight capacity markets just because of the premiums that are -- we're able to garner as we serve our contract carriers. So that would be probably the best way to go about it. And think also about our mix of business, particularly Logistics and Intermodal and where those will play kind of through the year and through the cycle.

Todd Clark Fowler - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

No, I appreciate that. And Chris, I think you're right. I mean, that's what I'm trying to get at. I don't want to set unrealistic expectations for the first part of the year, but what it sounds like is if we go back and look at the percent of earnings from the couple of years that we can piece together, that should be representative of what to expect here in '18.

Lori Lutey - *Schneider National, Inc. - CFO and EVP*

That will be close.

Todd Clark Fowler - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Got it, okay.

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

I think -- and then understand the dynamics. I think you'll get into a good spot.

Todd Clark Fowler - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Okay, good. That helps. And then just for a follow-up. I understand it feels like that net price is probably going to be the biggest potential driver for margin improvement. But if you had to kind of pick off a couple of other areas that we could think about, where there could be some margin opportunity into '18 or into '19 aside from the net price components, what would be some of the things that you would highlight for us?



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Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Sure. I'll take a couple of runs at that and see if Lori or Mark have something there. I -- one of the things that will be quite interesting, there's been a lot of discussion about how many new truck orders are out there. We still struggle to see that those are going to growth. We certainly haven't seen that kind of orientation in our biggest competitor. So it looks like it's more replacement. Anecdotally, we hear things about it going into the vocational market. So that might be part of it. But if you think about the implications of the ELD enforcement then what might happen with people who just choose to exit, I think the biggest -- well, not -- probably one of the bigger headwinds is what's going to happen to gain on sale in the used equipment market as we watch this dynamic play out. And we are running pretty disciplined, age-of-fleet kind of strategies. What does that really mean as we start to essentially buy new equipment and get rid of the aged equipment just merely to manage the replacement cycle is one that I think you might want to consider and think about how that plays out because we're certainly tuned into it and trying to see how that comes to play. Mark, is there anything you would add or...

Mark Rourke - *Schneider National, Inc. - COO and EVP*

Yes, we don't generally talk about it, but some of our specialty markets, like our liquid tanker bulk business, which is supporting the manufacturing sector with feedstock and what's going on and the kind of renaissance there and -- that's a place that I believe we can both have some growth and some continued margin performance improvement. We really, really like that business and how it's performing today, but we have a very unique Intermodal offering that supports that in addition to a really solid, over-the-road liquid tank business. And so -- and to get back to your -- maybe the question that Ben asked, would that be a place that we might have some interest in expanding customers and expanding reach because of the highly specialized nature of tanker customers and tanker business -- so that's one that we would put in high regard and look to further exploit our -- kind of our unique positioning there. Many of our large competitors are not playing in that space.

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Lori, anything or...

Lori Lutey - *Schneider National, Inc. - CFO and EVP*

No, I don't have anything to add.

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Okay.

Operator

Ladies and gentlemen, we are out of time for questions. At this point, I'd like to turn the call back to management for some final comments.

Christopher B. Lofgren - *Schneider National, Inc. - CEO, President and Director*

Well, thank you, everybody, for joining the call this evening. Again, we will typically try to do this as more of a morning call on this kind of a schedule, but we butted up against a very notable company that it was just, I think, in everyone's best interest that we move this. Appreciate the questions. It is a very, very interesting, and interesting in a positive way, environment in which we are, which we're facing. I think the company has dialed itself up again this year to be able to understand customer needs, to understand how we create value in unique and sustainable ways. And so we look forward to the year. It is going to come fast and hard. And next January, we'll be here before we actually know it. So I appreciate everybody's time and interest, and have a good evening, everyone.



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Operator

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.

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