

KNIGHT TRANSPORTATION INC  
Form 10-Q  
November 09, 2016

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

FORM 10-Q  
(Mark One)

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

For the quarterly period ended September 30, 2016

Or

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

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

Commission File Number: 001-32396

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

Arizona 86-0649974  
(I.R.S.  
(State or other jurisdiction of Employer  
incorporation or organization) Identification  
No.)

20002 North 19<sup>th</sup> Avenue  
Phoenix, Arizona  
85027  
(Address of Principal Executive Offices)  
(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this Chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares outstanding of registrant's common stock, par value \$0.01 per share, as of October 31, 2016, was 80,034,666 shares.

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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

## KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES

## Condensed Consolidated Unaudited Balance Sheets

(in thousands)

|   | September<br>30,<br>2016 | December<br>31,<br>2015 |
|---|--------------------------|-------------------------|
| <b>ASSETS</b>   |                          |                         |
| Current Assets:   |                          |                         |
| Cash and cash equivalents   | \$3,886                  | \$8,691                 |
| Trade receivables, net of allowance for doubtful accounts of \$3,014 and \$3,106, respectively    | 131,489                  | 131,945                 |
| Notes receivable, net of allowance for doubtful notes receivable of \$254 and \$273, respectively | 574                      | 648                     |
| Prepaid expenses  | 16,671                   | 17,320                  |
| Assets held for sale  | 18,347                   | 29,327                  |
| Other current assets  | 8,507                    | 14,215                  |
| Income tax receivable   | 8,845                    | 41,967                  |
| Total current assets  | 188,319                  | 244,113                 |
| Property and Equipment:   |                          |                         |
| Revenue equipment   | 905,195                  | 866,252                 |
| Land and land improvements  | 53,492                   | 52,951                  |
| Buildings and building improvements   | 143,734                  | 139,102                 |
| Furniture and fixtures  | 20,494                   | 18,363                  |
| Shop and service equipment  | 16,888                   | 16,729                  |
| Leasehold improvements  | 4,834                    | 3,061                   |
| Gross property and equipment  | 1,144,637                | 1,096,458               |
| Less: accumulated depreciation and amortization   | (331,458 )               | (292,815 )              |
| Property and equipment, net   | 813,179                  | 803,643                 |
| Notes receivable, long-term   | 3,198                    | 3,419                   |
| Goodwill  | 47,035                   | 47,050                  |
| Intangible assets, net  | 2,700                    | 3,075                   |
| Other long-term assets, restricted cash and investments   | 32,783                   | 18,932                  |
| Total long-term assets  | 898,895                  | 876,119                 |
| Total assets  | \$1,087,214              | \$1,120,232             |

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

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KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES  
Condensed Consolidated Unaudited Balance Sheets (continued)  
(in thousands, except par values)

|  | September<br>30,<br>2016 | December<br>31,<br>2015 |
|--|--------------------------|-------------------------|
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                          |                         |
| Current Liabilities:   |                          |                         |
| Accounts payable   | \$ 18,904                | \$ 14,818               |
| Accrued payroll and purchased transportation   | 21,262                   | 23,776                  |
| Accrued liabilities  | 16,539                   | 21,609                  |
| Claims accrual – current portion   | 20,288                   | 19,471                  |
| Dividend payable – current portion   | 298                      | 349                     |
| Total current liabilities  | 77,291                   | 80,023                  |
| Long-term Liabilities:   |                          |                         |
| Claims accrual – long-term portion   | 12,336                   | 11,508                  |
| Long-term dividend payable and other liabilities   | 1,854                    | 2,164                   |
| Deferred tax liabilities   | 177,201                  | 174,165                 |
| Long-term debt   | 52,000                   | 112,000                 |
| Total long-term liabilities  | 243,391                  | 299,837                 |
| Total liabilities  | 320,682                  | 379,860                 |
| Commitments and Contingencies (Note 6)   |                          |                         |
| Shareholders' Equity:  |                          |                         |
| Preferred stock, \$0.01 par value; 50,000 shares authorized; none issued and outstanding   | -                        | -                       |
| Common stock, \$0.01 par value; 300,000 shares authorized; 80,026 and 80,967 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively | 800                      | 810                     |
| Additional paid-in capital   | 219,593                  | 205,648                 |
| Accumulated other comprehensive income   | -                        | 2,573                   |
| Retained earnings  | 544,192                  | 529,367                 |
| Total Knight Transportation shareholders' equity   | 764,585                  | 738,398                 |
| Noncontrolling interest  | 1,947                    | 1,974                   |
| Total shareholders' equity   | 766,532                  | 740,372                 |
| Total liabilities and shareholders' equity   | \$ 1,087,214             | \$ 1,120,232            |

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

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## KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES

## Condensed Consolidated Unaudited Statements of Income

(in thousands, except per share data)

|  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|------------------------------------|-----------|
|  | 2016                                | 2015      | 2016                               | 2015      |
| <b>REVENUE:</b>                                    |                                     |           |                                    |           |
| Revenue, before fuel surcharge                     | \$256,243                           | \$269,930 | \$763,684                          | \$795,767 |
| Fuel surcharge                                     | 24,287                              | 30,192    | 65,252                             | 96,458    |
| Total revenue                                      | 280,530                             | 300,122   | 828,936                            | 892,225   |
| <b>OPERATING EXPENSES:</b>                         |                                     |           |                                    |           |
| Salaries, wages and benefits                       | 82,688                              | 85,514    | 250,732                            | 249,921   |
| Fuel   | 34,616                              | 39,795    | 94,815                             | 120,247   |
| Operations and maintenance                         | 19,781                              | 20,390    | 56,886                             | 62,065    |
| Insurance and claims                               | 9,251                               | 8,149     | 26,330                             | 25,076    |
| Operating taxes and licenses                       | 4,546                               | 3,373     | 14,645                             | 13,954    |
| Communications                                     | 976                                 | 849       | 3,224                              | 3,066     |
| Depreciation and amortization                      | 29,129                              | 28,204    | 86,486                             | 82,728    |
| Purchased transportation                           | 57,069                              | 62,115    | 168,772                            | 182,279   |
| Miscellaneous operating expenses                   | 5,540                               | 5,307     | 13,304                             | 18,541    |
| Total operating expenses                           | 243,596                             | 253,696   | 715,194                            | 757,877   |
| Income from operations                             | 36,934                              | 46,426    | 113,742                            | 134,348   |
| Interest income                                    | 83                                  | 140       | 259                                | 377       |
| Interest expense                                   | (182 )                              | (220 )    | (742 )                             | (714 )    |
| Other income                                       | 1,389                               | 2,335     | 4,602                              | 7,234     |
| Income before income taxes                         | 38,224                              | 48,681    | 117,861                            | 141,245   |
| Income taxes                                       | 14,558                              | 17,946    | 46,202                             | 52,379    |
| Net income   | 23,666                              | 30,735    | 71,659                             | 88,866    |
| Net income attributable to noncontrolling interest | (316 )                              | (452 )    | (1,064 )                           | (1,382 )  |
| Net income attributable to Knight Transportation   | \$23,350                            | \$30,283  | \$70,595                           | \$87,484  |
| <b>Earnings per share:</b>                         |                                     |           |                                    |           |
| Basic  | \$0.29                              | \$0.37    | \$0.88                             | \$1.07    |
| Diluted  | \$0.29                              | \$0.37    | \$0.87                             | \$1.06    |
| Dividends declared per share                       | \$0.06                              | \$0.06    | \$0.18                             | \$0.18    |
| <b>Weighted Average Shares Outstanding:</b>        |                                     |           |                                    |           |
| Basic  | 80,040                              | 81,127    | 80,284                             | 81,678    |
| Diluted  | 80,792                              | 82,005    | 80,985                             | 82,714    |

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



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## KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES

## Condensed Consolidated Unaudited Statements of Comprehensive Income

(in thousands)

|   | Three Months<br>Ended<br>September 30, |          | Nine Months<br>Ended<br>September 30, |          |
|---|--|----------|---------------------------------------|----------|
|   | 2016                                   | 2015     | 2016                                  | 2015     |
| Net income  | \$23,666                               | \$30,735 | \$71,659                              | \$88,866 |
| Other comprehensive income, net of tax:   |  |          |                                       |          |
| Realized gains from available-for-sale securities reclassified to net income <sup>(1)</sup>         | (878 )                                 | (1,307 ) | (2,771 )                              | (4,093 ) |
| Unrealized gain / (loss) from changes in fair value of available-for-sale securities <sup>(2)</sup> | 145                                    | (1,365 ) | 198                                   | (4,632 ) |
| Comprehensive income  | 22,933                                 | \$28,063 | 69,086                                | \$80,141 |
| Comprehensive income attributable to noncontrolling interest  | (316 )                                 | (452 )   | (1,064 )                              | (1,382 ) |
| Comprehensive income attributable to Knight Transportation  | \$22,617                               | \$27,611 | \$68,022                              | \$78,759 |

(1) Net of current income tax expense of \$546, \$823, \$1,723, and \$2,576, respectively.

(2) Net of deferred income tax expense / (benefit) of \$85, \$(875), \$104, and \$(3,024), respectively.

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



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KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES  
Condensed Consolidated Unaudited Statements of Cash Flows  
(in thousands)

|   | Nine Months Ended<br>September 30, |           |
|---|------------------------------------|-----------|
|   | 2016                               | 2015      |
| Cash Flows From Operating Activities:   |                                    |           |
| Net income  | \$71,659                           | \$88,866  |
| Adjustments to reconcile net income to net cash provided by operating activities:                       |                                    |           |
| Depreciation and amortization   | 86,486                             | 82,728    |
| Gain on sale of equipment   | (7,451 )                           | (12,181 ) |
| Gain from sale of available-for-sale securities   | (4,494 )                           | (6,669 )  |
| Gain from sale of Transportation Resource Partners I  | -                                  | (122 )    |
| Transportation Resource Partners I impairment   | 67                                 | -         |
| Income from investment in Transportation Resource Partners III  | (177 )                             | (443 )    |
| Non-cash compensation expense for issuance of common stock to certain members of the Board of Directors | 398                                | 354       |
| Provision for doubtful accounts and notes receivable  | 594                                | 1,216     |
| Excess tax benefits related to stock-based compensation   | (1,107 )                           | (3,064 )  |
| Stock-based compensation expense, net   | 3,126                              | 5,288     |
| Deferred income taxes   | 4,655                              | (12,281 ) |
| Changes in operating assets and liabilities:  |                                    |           |
| Trade receivables   | (133 )                             | 7,368     |
| Other current assets  | 5,707                              | (906 )    |
| Prepaid expenses  | 649                                | (6,049 )  |
| Income tax receivable   | 33,122                             | 9,719     |
| Other long-term assets  | 547                                | (1,643 )  |
| Accounts payable  | 1,869                              | (3,021 )  |
| Accrued liabilities and claims accrual  | (6,354 )                           | 7,479     |
| Net cash provided by operating activities   | 189,163                            | 156,639   |
| Cash Flows From Investing Activities:   |                                    |           |
| Purchases of property and equipment   | (126,028)                          | (166,790) |
| Proceeds from sale of equipment/assets held for sale  | 49,972                             | 57,938    |
| Proceeds from notes receivable  | 1,348                              | 1,442     |
| Change in restricted cash and investments   | (19 )                              | (25 )     |
| Proceeds from sale of available-for-sale securities   | 7,403                              | 9,339     |
| Cash payments to Transportation Resource Partners   | (21,778 )                          | -         |
| Cash proceeds from Transportation Resource Partners   | 423                                | 191       |
| Net cash used in investing activities   | (88,679 )                          | (97,905 ) |

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



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## KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES

Condensed Consolidated Unaudited Statements of Cash Flows (continued)

(in thousands)

|  | Nine Months Ended<br>September 30, |            |
|--|------------------------------------|------------|
|  | 2016                               | 2015       |
| Cash Flows From Financing Activities:                            |                                    |            |
| Dividends paid   | \$(14,753 )                        | \$(15,003) |
| Payments to repurchase company stock                             | (39,873 )                          | (45,345)   |
| Payments on line of credit borrowings, net                       | (60,000 )                          | (14,400)   |
| Excess tax benefits related to stock-based compensation          | 1,107                              | 3,064      |
| Cash distribution to noncontrolling interest holder              | (1,091 )                           | (603 )     |
| Proceeds from exercise of stock options                          | 9,321                              | 9,190      |
| Net cash used in financing activities                            | (105,289)                          | (63,097)   |
| Net decrease in Cash and Cash Equivalents                        | (4,805 )                           | (4,363 )   |
| Cash and Cash Equivalents, beginning of period                   | 8,691                              | 17,066     |
| Cash and Cash Equivalents, end of period                         | \$3,886                            | \$12,703   |
| Supplemental Disclosures:  |                                    |            |
| Non-cash investing and financing transactions:                   |                                    |            |
| Equipment acquired included in accounts payable                  | \$6,436                            | \$8,852    |
| Transfer from property and equipment to assets held for sale     | \$25,035                           | \$32,800   |
| Financing provided to independent contractors for equipment sold | \$1,024                            | \$571      |
| Net dividend accrued for restricted stock units                  | \$69                               | \$137      |
| Cash flow information:   |                                    |            |
| Income taxes paid  | \$7,238                            | \$52,000   |
| Interest expense paid  | \$782                              | \$749      |

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

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## KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

## Note 1. Financial Information

References in this Report on Form 10-Q to "we," "us," "our," "Knight," or the "Company" or similar terms refer to Knight Transportation, Inc. and its consolidated subsidiaries. All inter-company balances and transactions have been eliminated in consolidation.

The accompanying condensed consolidated unaudited financial statements of Knight Transportation, Inc. and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America and Regulation S-X, instructions to Form 10-Q, and other relevant rules and regulations of the Securities and Exchange Commission (the "SEC"), as applicable to the preparation and presentation of interim financial information. Certain information and footnote disclosures have been omitted or condensed pursuant to such rules and regulations. We believe all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Results of operations in interim periods are not necessarily indicative of results for a full year. These condensed consolidated unaudited financial statements and notes thereto should be read in conjunction with our consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015.

## Note 2. Stock-Based Compensation

In May 2015, our shareholders approved the Amended and Restated 2015 Omnibus Incentive Plan (the "2015 Plan"). This plan combines into a single plan the Company's 2005 Executive Cash Bonus Plan (the "2005 Plan") and the 2012 Equity Compensation Plan (the "2012 Plan") and allows for future grants under the 2015 Plan. Grants outstanding under the 2005 Plan and 2012 Plan will continue in force and effect and continue to be governed solely by the terms and conditions of the instrument evidencing such grants, and will be interpreted under the terms of the 2005 Plan and the 2012 Plan, as applicable. Since approval of the 2015 Plan in May 2015, all grants of stock-based compensation are made under the 2015 Plan. Stock-based compensation expense for the three months and nine months ended September 30, 2016, and 2015, are as follows (dollars in thousands):

|  | Three Months<br>Ended<br>September 30,<br>2016 |         | Nine Months<br>Ended<br>September 30,<br>2015 |         |
|--|--|---------|---|---------|
| Stock compensation expense for options, net of forfeitures   | \$434  | \$307   | \$1,318                                       | \$754   |
| Stock compensation expense for restricted stock units and performance restricted stock units, net of forfeitures | 112  | 1,380   | 1,808   | 4,534   |
| Total stock compensation expense   | \$546  | \$1,687 | \$3,126                                       | \$5,288 |

Our policy is to recognize compensation expense on a straight-line basis over the requisite service period for the entire award.

As of September 30, 2016, we have approximately \$3.8 million of unrecognized compensation expense related to unvested options. This cost is expected to be recognized over a weighted-average period of 1.8 years and a total period of 3.4 years. We have approximately \$8.8 million of unrecognized compensation expense related to restricted stock unit awards, which is anticipated to be recognized over a weighted-average period of 3.4 years and a total period of 6.3 years. We also have approximately \$6.0 million of unrecognized compensation cost related to unvested

performance awards. That cost is expected to be recognized over a weighted-average period of 2.6 years and total period of 3.3 years.

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A total of 569,480 and 590,141 stock options were granted during the first nine months of 2016 and 2015, respectively. We received approximately \$9.3 million in cash from the exercise of stock options during the nine months ended September 30, 2016, compared to \$9.2 million for the same period in 2015.

A summary of the option award activity under our equity compensation plans as of September 30, 2016, and changes during the nine months ended September 30, 2016, is presented below:

|                                      | Option<br>Totals | Weighted<br>Average<br>Exercise<br>Price Per<br>Share |
|--------------------------------------|------------------|---|
| Outstanding as of December 31, 2015  | 2,008,872        | \$ 21.41  |
| Granted                              | 569,480          | 24.23   |
| Exercised                            | (522,613 )       | 17.87   |
| Forfeited                            | (109,404 )       | 25.02   |
| Outstanding as of September 30, 2016 | 1,946,335        | \$ 23.46  |

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option valuation model. Listed below are the weighted-average assumptions used for the fair value computation:

|  | Nine Months Ended<br>September 30, |            |
|--|------------------------------------|------------|
|  | 2016                               | 2015       |
| Dividend yield <sup>(1)</sup>                  | 0.99%                              | 0.80%      |
| Expected volatility <sup>(2)</sup>             | 27.91%                             | 25.88%     |
| Risk-free interest rate <sup>(3)</sup>         | 0.90%                              | 0.98%      |
| Expected term <sup>(4)</sup>                   | 2.74 years                         | 2.74 years |
| Weighted-average fair value of options granted | \$4.28                             | \$5.00     |

<sup>(1)</sup>Dividend yield – the dividend yield is based on our historical experience and future expectation of dividend payouts.

<sup>(2)</sup>Expected volatility – we analyzed the volatility of our stock using historical data.

<sup>(3)</sup>Risk-free interest rate – the risk-free interest rate assumption is based on U.S. Treasury securities at a constant maturity with a maturity period that most closely resembles the expected term of the stock option award.

Expected term – the expected term of employee stock options represents the weighted-average period the stock

<sup>(4)</sup>options are expected to remain outstanding and has been determined based on an analysis of historical exercise behavior.

A total of 10,222 and 13,950 restricted stock unit awards were granted during the first nine months of 2016 and 2015, respectively. A summary of the restricted stock unit award activity under our equity compensation plans as of September 30, 2016, and changes during the nine months ended September 30, 2016, is presented below:

|                                  | Number of<br>Restricted<br>Stock Unit<br>Awards | Weighted<br>Average<br>Grant<br>Date<br>Fair<br>Value |
|----------------------------------|---|---|
| Unvested as of December 31, 2015 | 879,173   | \$ 16.45  |

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|                                   |            |          |
|-----------------------------------|------------|----------|
| Granted                           | 10,222     | 27.37    |
| Vested                            | (162,467 ) | 16.66    |
| Forfeited                         | (24,860 )  | 16.24    |
| Unvested as of September 30, 2016 | 702,068    | \$ 16.57 |

The fair value of each restricted stock unit is based on the closing market price on the date of grant.

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Beginning in 2014, we issued performance restricted stock units (“PRSUs”) to selected key employees that may be earned based on revenue growth and return on assets, and may then be modified based on our total shareholder return, as defined in the instrument evidencing the grant, over a three-year period. The primary award adjustment may range from 0 percent to 150 percent of the initial grant, based upon performance achieved over the three-year period. The primary award modifier, which would multiply the adjusted primary award by 75 percent to 125 percent, is measured by determining the percentile rank of the total shareholder return, as defined in the instrument evidencing the grant, of Knight Transportation common stock in relation to the total shareholder return of a peer group for the three-year period. The final award will be based on performance achieved in accordance with the scale set forth in the plan agreement. PRSUs do not earn dividend equivalents.

A total of 177,741 and 165,720 PRSUs were granted in the first nine months of 2016 and 2015, respectively. A summary of the performance restricted stock unit award activity under our equity compensation plans for the nine months ended September 30, 2016 is presented below:

|                                   | Number of<br>Performance<br>Restricted<br>Stock Unit<br>Awards | Weighted<br>Average<br>Grant<br>Date<br>Fair<br>Value |
|-----------------------------------|--|---|
| Unvested as of December 31, 2015  | 341,782  | \$ 26.46  |
| Granted                           | 177,741  | 23.89   |
| Shares earned above target        | 2,516  | 23.85   |
| Vested                            | (5,391 )   | 23.85   |
| Cancelled                         | (8,170 )   | 25.21   |
| Unvested as of September 30, 2016 | 508,478  | \$ 25.60  |

The number of granted shares, cancelled shares, and unvested shares are included in the table above based on the performance target established at the initial grant date.

The performance measurement period for the awards granted in the nine months ended September 30, 2016, is January 1, 2016 to December 31, 2018. These awards will vest January 31, 2020, or thirteen months following the expiration of the performance period. The fair value of each PRSU grant is estimated on the date of grant using the Monte Carlo Simulation valuation model. Listed below are the weighted-average assumptions used for the fair value computation:

|   | Nine Months<br>Ended<br>September 30, |         |
|---|---------------------------------------|---------|
|   | 2016                                  | 2015    |
| Dividend yield <sup>(1)</sup>                       | 0.99 %                                | 0.80 %  |
| Expected volatility <sup>(2)</sup>                  | 27.95 %                               | 23.18 % |
| Average peer volatility <sup>(2)</sup>              | 34.37 %                               | 30.70 % |
| Average peer correlation coefficient <sup>(3)</sup> | 0.60                                  | 0.49    |
| Risk-free interest rate <sup>(4)</sup>              | 0.89 %                                | 0.78 %  |
| Expected term <sup>(5)</sup>                        | 2.84                                  | 2.63    |
| Weighted-average fair value of PRSUs granted        | \$23.89                               | \$29.30 |

(1)



The dividend yield, used to project stock price to the end of the performance period, is based on our historical experience and future expectation of dividend payouts. Total shareholder return is determined assuming that dividends are reinvested in the issuing entity over the performance period, which is mathematically equivalent to utilizing a 0% dividend yield.

(2) We (or peer company) estimated volatility using our (or their) historical share price performance over the remaining performance period as of the grant date.

(3) The correlation coefficients are used to model the way in which each entity tends to move in relation to each other; the correlation assumptions were developed using the same stock price data as the volatility assumptions.

(4) The risk-free interest rate assumption is based on U.S. Treasury securities at a constant maturity with a maturity period that most closely resembles the expected term of the performance award.

(5) Since the Monte Carlo simulation valuation is an open form model that uses an expected life commensurate with the performance period, the expected life of the PRSUs was assumed to be the period from the grant date to the end of the performance period.

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## Note 3. Earnings Per Share

A reconciliation of the basic and diluted earnings per share computations for the three months and nine months ended September 30, 2016 and 2015, respectively, is as follows (dollars in thousands except per share data):

|  | Three Months  |          | Nine Months   |          |
|--|---------------|----------|---------------|----------|
|  | Ended         |          | Ended         |          |
|  | September 30, |          | September 30, |          |
|  | 2016          | 2015     | 2016          | 2015     |
| Weighted-average common shares outstanding – basic                   | 80,040        | 81,127   | 80,284        | 81,678   |
| Dilutive effect of stock options and unvested restricted stock units | 752           | 878      | 701           | 1,036    |
| Weighted-average common shares outstanding – diluted                 | 80,792        | 82,005   | 80,985        | 82,714   |
| Net income attributable to Knight Transportation                     | \$23,350      | \$30,283 | \$70,595      | \$87,484 |
| Basic earnings per share   | \$0.29        | \$0.37   | \$0.88        | \$1.07   |
| Diluted earnings per share   | \$0.29        | \$0.37   | \$0.87        | \$1.06   |

Certain shares of options, restricted stock units, and PRSUs (collectively, “equity awards”) were excluded from the computation of diluted earnings per share because the equity award’s exercise prices were greater than the average market price of the common shares and the sum total of assumed proceeds resulted in fewer shares repurchased than the weighted equity awards outstanding hypothetically exercised per the treasury method.

The number of anti-dilutive shares are:

|                                | Three Months  |         | Nine Months   |         |
|--------------------------------|---------------|---------|---------------|---------|
|                                | Ended         |         | Ended         |         |
|                                | September 30, |         | September 30, |         |
|                                | 2016          | 2015    | 2016          | 2015    |
| Number of anti-dilutive shares | 937,040       | 597,076 | 1,071,800     | 322,036 |

## Note 4. Segment Information

We have two operating and reportable segments: (i) the Trucking segment comprised of three operating units (Dry Van, Refrigerated, and Drayage), and (ii) the Logistics segment comprised of two operating units (Brokerage and Intermodal). We also provide logistics, freight management and other non-trucking services through our Logistics businesses. Through our Trucking and Logistics segment capabilities, we are able to transport, or can arrange for the transportation of, general commodities for customers throughout the United States and parts of Canada and Mexico.

In determining our reportable segments, we focus on financial information such as operating revenues and expenses, operating income, operating ratios, and other key operating statistics common in the industry. The chief operating decision maker also uses this information to evaluate segment performance and allocate resources to our operations.

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Our segments provide transportation and related services for one another. Such services are billed at cost, and no profit is earned. Such intersegment revenues and expenses are eliminated in our consolidated results.

The following table sets forth revenue and operating income between the Trucking and Logistics segments for the three months and nine months ended September 30, 2016 and 2015 (dollars in thousands).

|                                     | Three Months<br>Ended<br>September 30,<br>2016 |        | Three Months<br>Ended<br>September 30,<br>2015 |        | Nine Months<br>Ended<br>September 30,<br>2016 |        | Nine Months<br>Ended<br>September 30,<br>2015 |        |
|-------------------------------------|--|--------|--|--------|---|--------|---|--------|
| <u>Revenues:</u>                    | \$   | %      | \$   | %      | \$  | %      | \$  | %      |
| Trucking Segment                    | \$228,590                                      | 81.5   | \$242,046                                      | 80.6   | \$672,969                                     | 81.2   | \$722,963                                     | 81.0   |
| Logistics Segment                   | 53,643   | 19.1   | 62,773   | 20.9   | 163,955                                       | 19.8   | 181,339                                       | 20.3   |
| Subtotal                            | 282,233  |        | 304,819  |        | 836,924                                       |        | 904,302                                       |        |
| Intersegment Eliminations Trucking  | (34 )  | 0.0    | (38 )  | 0.0    | (106 )  | 0.0    | (116 )  | 0.0    |
| Intersegment Eliminations Logistics | (1,669 )                                       | (0.6 ) | (4,659 )                                       | (1.5 ) | (7,882 )                                      | (1.0 ) | (11,961 )                                     | (1.3 ) |
| Total                               | \$280,530                                      | 100 %  | \$300,122                                      | 100 %  | \$828,936                                     | 100 %  | \$892,225                                     | 100 %  |
| <br><u>Operating Income:</u>        |  |        |  |        |   |        |   |        |
| Trucking Segment                    | \$34,439                                       | 93.2   | \$42,710                                       | 92.0   | \$105,647                                     | 92.9   | \$122,800                                     | 91.4   |
| Logistics Segment                   | 2,495  | 6.8    | 3,716  | 8.0    | 8,095   | 7.1    | 11,548  | 8.6    |
| Total                               | \$36,934                                       | 100 %  | \$46,426                                       | 100 %  | \$113,742                                     | 100 %  | \$134,348                                     | 100 %  |

No segmental asset or liability information is provided as we do not prepare balance sheets by segment, and the chief operating decision maker does not review segment assets or liabilities to make operating decisions.

## Note 5. Joint Ventures

In 2014, we formed an Arizona limited liability company, Kool Trans, LLC, for the purpose of expanding our refrigerated trucking business. In 2015, we changed the company name to Kold Trans, LLC. We are entitled to 80% of the profits of the entity and have effective control over the management of the entity. In accordance with ASC 810-10-15-8, Consolidation, we consolidate the financial activities of this entity into these condensed consolidated financial statements. The noncontrolling interest for this entity is presented as a separate component of the condensed consolidated financial statements.

In 2010, we partnered with a non-related investor to form an Arizona limited liability company for the purpose of sourcing commercial vehicle parts. We contributed \$26,000 to acquire 52% ownership of this entity. In accordance with ASC 810-10-15-8, Consolidation, we consolidate the financial activities of this entity into the condensed consolidated financial statements. The noncontrolling interest for this entity is presented as a separate component of the condensed consolidated financial statements.

## Note 6. Commitments and Contingencies

We are a party to certain claims and pending litigation arising in the normal course of business. These proceedings primarily involve claims for personal injury, property damage, physical damage, and cargo loss incurred in the transportation of freight or for personnel matters, as well as certain class action litigation in which plaintiffs allege failure to provide meal and rest breaks, unpaid wages, unauthorized deductions, and other items.

We are insured against auto liability (“AL”) claims under a primary self-insured retention (“SIR”) policy with retention ranging from \$1.0 million to \$3.0 million per occurrence and in some years, depending on the applicable policy year, we have been responsible for aggregate losses up to \$1.5 million within the primary AL layer. For the policy periods March 1, 2016 to March 1, 2017, and March 1, 2015 to March 1, 2016, the SIR is \$2.5 million with no additional aggregate limits or deductibles within the primary AL policy. We have secured excess liability coverage up to \$130.0 million per occurrence for the policy period March 1, 2016 to March 1, 2017. For policy period March 1, 2015 to March 1, 2016, our excess liability coverage limit was \$105.0 million per occurrence. We also carry a \$2.5 million aggregate deductible for any loss or losses within the excess coverage layer.

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We are self-insured for workers' compensation coverage. On March 31, 2016, the self-retention level was increased from a maximum \$500,000 per occurrence to a maximum \$1.0 million per occurrence. We also maintain primary and excess coverage for employee medical expenses and hospitalization, with self-insured retention of \$240,000 per claimant in 2016, and \$225,000 per claimant in 2015.

Based on our present knowledge of the facts, and in certain cases, advice of outside counsel, management believes the resolution of open claims and pending litigation, taking into account existing reserves, and accrued liabilities recorded is not likely to have a materially adverse effect on our consolidated financial statements.

## Note 7. Property and Equipment

To ensure that our facilities remain modern and efficient, we periodically have facility upgrades, or new construction, in process at our various service center or corporate headquarters locations. Until these projects are completed, we consider these to be assets not yet placed in service and they are not depreciated. Once they are placed into service, we depreciate them according to our depreciation policy. At September 30, 2016 and December 31, 2015, we had approximately \$10.4 million and \$17.5 million, respectively, of facility construction in process assets included under "Buildings and building improvements" on the accompanying condensed consolidated balance sheets.

## Note 8. Goodwill and Intangibles, net

Goodwill represents the excess of the purchase price of our acquisitions over the fair value of the net assets acquired. The tax benefit from the recognition on the tax return of the amortization of the excess tax goodwill over book goodwill is treated as a reduction in the book basis of goodwill.

The changes in the carrying amounts of goodwill were as follows (dollars in thousands):

|  |  |
|--|--|
|  | Nine<br>Months<br>Ended<br>September<br>30, 2016 |
| Goodwill at beginning of period              | \$ 47,050  |
| Amortization relating to deferred tax assets | (15 )  |
| Goodwill at end of period                    | \$ 47,035  |

In conjunction with our acquisitions, identifiable intangible assets subject to amortization have been recorded at fair value and are being amortized over a weighted-average amortization period of 7.6 years.

Intangible asset balances were as follows (dollars in thousands):

|                          |                          |                         |
|--------------------------|--------------------------|-------------------------|
|                          | September<br>30,<br>2016 | December<br>31,<br>2015 |
| Gross carrying amount    | \$ 3,700                 | \$ 3,700                |
| Accumulated amortization | (1,000 )                 | (625 )                  |
| Intangible assets, net   | \$ 2,700                 | \$ 3,075                |

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Amortization expense associated with these intangible assets was \$0.1 million and \$0.4 million for the three and nine months ended September 30, 2016, and 2015, respectively, and is included in "Depreciation and amortization" on the accompanying condensed consolidated statements of income. Future amortization expense for intangible assets is estimated at \$0.1 million for the remainder of 2016, \$0.5 million for each of the years 2017 through 2019, and \$0.4 million in 2020 and 2021.

#### Note 9. Investments and Related Commitments

In 2003, we signed a partnership agreement with Transportation Resource Partners ("TRP"), a company that makes privately negotiated equity investments. Per the original partnership agreement, we committed to invest \$5.0 million in TRP. In 2006, we increased the commitment amount to \$5.5 million. Although no gain or loss was recognized from TRP investment activity in the three or nine month periods in 2016, we recorded impairment of \$67,000 for an other-than-temporary loss on the investment in the three months ended September 30, 2016. No impairment was recorded in the three or nine month periods in 2015, but we recognized a net gain of \$122,000 from TRP investment activity in the nine months ended September 30, 2015. The carrying value of our investment in TRP was \$233,400 at September 30, 2016 and \$300,000 at December 31, 2015. Our investment in TRP is accounted for using the cost method, and the balance is included within "Other long-term assets, restricted cash and investments" on our accompanying condensed consolidated balance sheets.

In 2008, we formed Knight Capital Growth, LLC and committed \$15.0 million to invest in another partnership managed and operated by the managers and principals of TRP. This partnership, Transportation Resource Partners III, LP ("TRP III"), is focused on investment opportunities similar to TRP. In 2015, TRP III released us from \$2.1 million of our outstanding commitment. As of September 30, 2016, we have contributed approximately \$11.1 million to TRP III, leaving an outstanding commitment of \$1.8 million. Our investment in TRP III is accounted for using the equity method. For the three months ended September 30, 2016, we recorded income of approximately \$32,100, for our investment in TRP III, and \$204,000 for the three months ended September 30, 2015. For the nine months ended September 30, 2016 and 2015, we recognized income of \$177,000, and \$443,000, respectively, for TRP III. The carrying value of our investment in TRP III was \$5.6 million and \$5.8 million as of September 30, 2016 and December 31, 2015, respectively, and is included within "Other long-term assets, restricted cash and investments" on our accompanying condensed consolidated balance sheets.

In 2015, we committed to invest in another TRP partnership, TRP Capital Partners, LP ("TRP IV"). TRP IV is managed and operated by the managers and principals of TRP and TRP III, and is focused on similar investment opportunities. We committed to contribute a total of \$4.9 million to TRP IV, and have contributed approximately \$2.1 million, leaving an outstanding commitment of approximately \$2.8 million as of September 30, 2016. Our investment in TRP IV is accounted for using the cost method, and the balance is included within "Other long-term assets, restricted cash and investments" on our accompanying condensed consolidated balance sheets.

In the first quarter of 2016, we committed to invest in another TRP partnership, TRP CoInvest Partners, (NTI) I, LP ("TRP Coinvestment"). The new partnership is managed and operated by the managers and principals of the other TRP partnerships, and is focused on similar investment opportunities. We committed to contribute, and have paid a total of, \$10.0 million to the new partnership, leaving no outstanding commitment as of September 30, 2016. Our investment in TRP Coinvestment is accounted for using the equity method, and the carrying value at September 30, 2016 was \$10.0 million and is included within "Other long-term assets, restricted cash and investments" on our accompanying condensed consolidated balance sheets.

In the third quarter of 2016, we committed to invest in another TRP partnership, TRP CoInvest Partners, (QLS) I, LP ("TRP Coinvestment QLS"). The new partnership is managed and operated by the managers and principals of the other TRP partnerships, and is focused on similar investment opportunities. We committed to contribute, and have paid a

total of, \$9.7 million to the new partnership, leaving no outstanding commitment as of September 30, 2016. Our investment in TRP Coinvestment is accounted for using the equity method, and the carrying value at September 30, 2016 was \$9.7 million and is included within "Other long-term assets, restricted cash and investments" on our accompanying condensed consolidated balance sheets.

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## Note 10. Marketable Equity Securities

We have certain marketable equity securities classified as available-for-sale securities, which are recorded at fair value with unrealized gains and losses, net of tax, as a component of "Accumulated other comprehensive income" in shareholders' equity on the accompanying condensed consolidated balance sheets. Realized gains and losses on available-for-sale securities are included in the determination of net income. We use specific identification to determine the cost of securities sold, or amounts reclassified out of accumulated other comprehensive income into earnings and included in "Other income" on the accompanying condensed consolidated statements of income.

The following table shows the Company's realized gains during the three and nine month periods ended September 30, 2016 and 2015, on certain securities that were classified as available-for-sale (dollars in thousands).

|                              | Three Months  |         | Nine Months   |         |
|------------------------------|---------------|---------|---------------|---------|
|                              | Ended         |         | Ended         |         |
|                              | September 30, |         | September 30, |         |
|                              | 2016          | 2015    | 2016          | 2015    |
| Realized gains               |               |         |               |         |
| Sales proceeds               | \$2,220       | \$3,151 | \$7,403       | \$9,339 |
| Cost of securities sold      | 796           | 1,021   | 2,909         | 2,670   |
| Realized gain                | \$1,424       | \$2,130 | \$4,494       | \$6,669 |
| Realized gains, net of taxes | \$878         | \$1,307 | \$2,771       | \$4,093 |

During the third quarter, we disposed of our holdings in available-for-sale equity investments leaving no balance on the accompanying condensed consolidated balance sheet as of September 30, 2016. As of December 31, 2015, our available-for-sale investment balance was approximately \$7.1 million, including gross unrealized gains of approximately \$4.2 million, or \$2.6 million (net of tax), and was included in "Other long-term assets, restricted cash and investments" on the accompanying condensed consolidated balance sheet.

## Note 11. Assets Held for Sale

Revenue equipment that is not utilized in continuing operations and is held for sale is classified as "Assets held for sale" on the accompanying condensed consolidated balance sheets. Assets held for sale at September 30, 2016 and December 31, 2015, totaled \$18.3 million and \$29.3 million, respectively. Assets held for sale are no longer subject to depreciation, and are recorded at the lower of depreciated carrying value or fair market value less selling costs. We expect to sell these assets and replace them with new assets within twelve months of being classified as "Assets held for sale."

## Note 12. Income Taxes

We account for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. For interim reporting purposes, our income tax provisions are recorded based on the estimated annual effective tax rate. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.





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We record net deferred tax assets to the extent we believe these assets will more likely than not be realized. In making such determination, we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and recent financial operations. A valuation allowance for deferred tax assets has not been deemed necessary due to our profitable operations.

We recognize a tax benefit from an uncertain tax position when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. We file federal and state income tax returns with varying statutes of limitations. The 2012 through 2015 tax years remain subject to examination by federal and state tax authorities. As of September 30, 2016, cumulative gross unrecognized tax benefits were \$0.7 million. We had no unrecognized tax benefits as of December 31, 2015. All unrecognized tax benefits, if recognized, would affect the effective tax rate.

With the exception of the unrecognized tax benefits discussed above, we believe that our income tax filing positions and deductions will be sustained upon audit and do not anticipate any adjustments that will result in a material change to our consolidated financial position, results of operations and cash flows. Our policy is to recognize interest and penalties related to unrecognized tax benefits as income tax expense. No interest or penalties related to unrecognized tax benefits has been recognized as of September 30, 2016 or December 31, 2015, because the Company has not yet received the refunds related to the uncertain tax benefits. None of the unrecognized tax benefits are expected to reverse in the next 12 months.

### Note 13. Company Share Repurchase Programs

In 2011, our Board of Directors unanimously authorized the repurchase of 10.0 million shares of our common stock. The repurchase authorization is intended to afford flexibility to acquire shares opportunistically in future periods and does not indicate an intention to repurchase any particular number of shares within a definite timeframe. Any repurchases would be effected based upon share price and market conditions. The Company's share repurchase program does not obligate it to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Exchange Act.

Under the share repurchase program, we repurchased 0.1 million shares for \$3.3 million in the three months ended September 30, 2016, and 1.6 million shares for \$39.9 million in the nine months ended September 30, 2016. We repurchased 0.6 million shares for \$15.0 million in the three months ended September 30, 2015, and 1.6 million shares for \$45.3 million in the nine months ended September 30, 2015. As of September 30, 2016, there were 4.3 million shares remaining for future purchases under our repurchase program. The repurchase authorization will remain in effect until the share limit is reached or the program is terminated.

### Note 14. Fair Value Measurements

Our assets and liabilities measured at fair value are based on principles set forth in ASC 820-10, Fair Value Measurements and Disclosure, for recurring and non-recurring fair value measurements of financial and non-financial assets and liabilities. This standard defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles in the United States, and expands disclosures about fair value measurements. This standard establishes a three-level hierarchy for fair value measurements based upon the significant inputs used to determine fair value. Observable inputs are those which are obtained from market participants external to us while unobservable inputs are generally developed internally, utilizing management's estimates, assumptions, and specific knowledge of the nature of the assets or liabilities and related markets. The three levels are defined as follows:

Level 1 – Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access at the measurement date. An active market is defined as a market in which transactions for the assets or liabilities occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

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Level 2 – Inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active (markets with few transactions), inputs other than quoted prices that are observable for the asset or liability (i.e., interest rates, yield curves, etc.), and inputs that are derived principally from or corroborated by observable market data correlation or other means (market corroborated inputs).

Level 3 – Unobservable inputs, only used to the extent that observable inputs are not available, reflect our assumptions about the pricing of an asset or liability.

In accordance with the fair value hierarchy described above, the following table shows the fair value of our financial assets and liabilities that are required to be measured at fair value as of September 30, 2016 and December 31, 2015 (dollars in thousands).

|  | Total<br>Balance<br>at<br>September<br>30, 2016 | Total<br>Balance<br>at<br>December<br>31, 2015 | Level One<br>Balance<br>at<br>September<br>30, 2016 | Level One<br>Balance<br>at<br>December<br>31, 2015 | Level Two<br>Balance<br>at<br>September<br>30, 2016 | Level Two<br>Balance<br>at<br>December<br>31, 2015 | Level Three<br>Balance<br>at<br>September<br>30, 2016 | Level Three<br>Balance<br>at<br>December<br>31, 2015 |
|--|---|--|---|--|---|--|---|--|
| Assets:                                |   |  |   |  |   |  |   |  |
| Available-for-sale securities:         |   |  |   |  |   |  |   |  |
| Equity securities - common shares      | -   | \$ 7,101                                       | -   | \$ 7,101   | -   | -  | -   | -  |
| Restricted cash and investments:       |   |  |   |  |   |  |   |  |
| Money market funds                     | \$ 1,261  | \$ 1,003                                       | \$ 1,261  | \$ 1,003   | -   | -  | -   | -  |
| Trading securities:                    |   |  |   |  |   |  |   |  |
| Debt securities - municipal securities | \$ 2,040  | \$ 2,279                                       | -   | -  | \$ 2,040  | \$ 2,279   | -   | -  |

## Note 15. Notes Receivable

We provide financing to independent contractors and third parties on equipment sold or leased under our equipment sale program. Most of the notes are collateralized and are due in weekly installments, comprised of principal and interest payments. Interest rates are set forth in the contracts and generally range from 2.0% to 20%.

The notes receivable balances are classified separately between current and long-term on the accompanying condensed consolidated balance sheets. The current and long-term balance of our notes receivable at September 30, 2016 and December 31, 2015, are as follows (dollars in thousands):

|   | September<br>30,<br>2016 | December<br>31,<br>2015 |
|---|--------------------------|-------------------------|
| Notes receivable from independent contractors | \$ 1,093                 | \$ 794                  |
| Notes receivable from third parties           | 2,933                    | 3,546                   |
| Gross notes receivable                        | 4,026                    | 4,340                   |
| Allowance for doubtful notes receivable       | (254 )                   | (273 )                  |
| Total notes receivable, net of allowance      | 3,772                    | 4,067                   |
| Current portion, net of allowance             | 574                      | 648                     |
| Long-term portion                             | \$ 3,198                 | \$ 3,419                |



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Note 16. Line of Credit

We maintain a revolving line of credit which permits revolving borrowings and letters of credit. The line of credit is maintained at \$300.0 million and matures December 1, 2017. Effective August 8, 2016, we entered into a modification to our line of credit agreement that extends the maturity date to August 1, 2019, and amends our minimum tangible net worth covenant to \$500.0 million from \$400.0 million. We incur interest on borrowings under the line of credit at the prime rate or LIBOR plus 0.625%, determined by us at the time of borrowing. We had \$52.0 million outstanding under the line of credit as of September 30, 2016, compared to \$112.0 million as of December 31, 2015. The weighted average variable annual percentage rate ("APR") for amounts borrowed during the nine months ended September 30, 2016 was 1.07%. Borrowings under the line of credit are recorded in the "Long-term debt" line of the accompanying condensed consolidated balance sheets. As of September 30, 2016, we also utilized \$31.1 million of the line of credit for letters of credit issued to various regulatory authorities and insurance carriers in connection with our self-insurance programs. With the outstanding letters of credit and debt borrowed, we have \$216.9 million available for future borrowings as of September 30, 2016. After consideration of fees incurred for the unused portion of our line of credit, our weighted average variable APR for the nine months ended September 30, 2016 was 1.27%. We are obligated to comply with certain financial and other covenants under the line of credit agreement and were in compliance with such covenants at and for the three and nine months ended September 30, 2016 and for the year ended December 31, 2015.

Note 17. Recent Accounting Pronouncements

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 203): Classification of Certain Cash receipts and Cash Payments. This update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. This ASU is effective for reporting periods beginning after December 15, 2017. We are currently evaluating the new guidance to determine the impact it may have on our condensed consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvement to Employee Share-based Payment Accounting. The objective of this update is to simplify several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This ASU is effective for reporting periods beginning after December 15, 2016, with early adoption permitted. We are currently evaluating the new guidance to determine the impact it may have on our condensed consolidated financial statements.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net). This update clarifies the implementation guidance on principal versus agent considerations. The guidance includes indicators to assist an entity in determining whether it controls a specified good or service before it is transferred to the customers. The amendments in this update affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which requires revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which we expect to be entitled in exchange for those goods or services. The guidance in this update supersedes virtually all present U.S. GAAP guidance on revenue recognition. The amendments to the standard require the use of more estimates and judgments than the present standards and require additional disclosures. The amendments in these updates will be effective for reporting periods beginning after December 15, 2017. We are currently evaluating the effect that this guidance will have on our condensed consolidated financial statements and related disclosures and have not yet selected a transition method.

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In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This update seeks to increase the transparency and comparability among entities by requiring public entities to recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements. To satisfy the standard's objective, a lessee will recognize a right-of-use asset representing its right to use the underlying asset for the lease term and a lease liability for the obligation to make lease payments. Both the right-of-use asset and lease liability will initially be measured at the present value of the lease payments, with subsequent measurement dependent on the classification of the lease as either a finance or an operating lease. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term. Accounting by lessors will remain mostly unchanged from current U.S. GAAP.

In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that companies may elect to apply. These practical expedients relate to the identification and classification of leases that commenced before the effective date, initial direct costs for leases that commenced before the effective date, and the ability to use hindsight in evaluating lessee options to extend or terminate a lease or to purchase the underlying asset. The transition guidance also provides specific guidance for sale and leaseback transactions, build-to-suit leases, leveraged leases, and amounts previously recognized in accordance with the business combinations guidance for leases. The new standard is effective for public companies for annual periods beginning after December 15, 2018, and interim periods within those years, with early adoption permitted. We are currently evaluating the effect that adopting this standard will have on our condensed consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments—Overall (Subtopic 825-10). This update was issued to enhance the reporting model for financial instruments regarding certain aspects of recognition, measurement, presentation, and disclosure. The update (i) requires equity investments (except those accounted for under the equity method or that are consolidated) to be measured at fair value with changes in fair value recognized in net income; (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) eliminates the requirement for an entity to disclose the methods and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost; (iv) requires an entity to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and (v) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or in the accompanying notes to the financial statements. These provisions are effective for annual reporting periods beginning after December 15, 2017, and interim periods within those annual periods. The standard is to be applied using a cumulative-effect adjustment to the balance sheet as of the beginning of the year of adoption. We are currently evaluating the effect that adopting this standard will have on our condensed consolidated financial statements.

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

### Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report contains certain statements that may be considered "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Section 27A of the Securities Act of 1933, as amended, and such statements are subject to the safe harbor created by those sections and the Private Securities Litigation Reform Act of 1995, as amended. All statements, other than statements of historical or current fact, are statements that could be deemed forward-looking statements, including without limitation: any projections of earnings, revenues, cash flows, dividends, capital expenditures, or other financial items; any statement of plans, strategies, and objectives of management for future operations; any statements concerning proposed acquisition plans, new services or developments; any statements regarding future economic conditions or

performance; and any statements of belief and any statement of assumptions underlying any of the foregoing. In this Item 2, statements relating to the ability of our infrastructure to support future growth, the flexibility of our model to adapt to market conditions, our ability to recruit and retain qualified drivers, our ability to react to

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market conditions, our ability to gain market share, future tractor prices, potential acquisitions, our equipment purchasing plans and equipment turnover, the expected freight environment and economic trends, whether we grow organically, our ability to obtain favorable pricing terms from vendors and suppliers, expected liquidity and methods for achieving sufficient liquidity, future fuel prices, future third-party service provider relationships and availability, future compensation arrangements with independent contractors and drivers, our expected need or desire to incur indebtedness, expected sources of liquidity for capital expenditures and allocation of capital, expected tractor trade-ins, expected sources of working capital and funds for acquiring revenue equipment, expected capital expenditures, future asset utilization, future capital requirements, future trucking capacity, future consumer spending, expected freight demand and volumes, future rates, future depreciation and amortization, expected tractor and trailer fleet age, regulatory changes and the impact thereof, and future purchased transportation expense, among others, are forward-looking statements. Such statements may be identified by their use of terms or phrases such as "believe," "may," "could," "expects," "estimates," "projects," "anticipates," "plans," "intends," "hope," and similar terms and phrases. Forward-looking statements are based on currently available operating, financial, and competitive information. Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified, which could cause future events and actual results to differ materially from those set forth in, contemplated by, or underlying the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Item 1A. Risk Factors," set forth in our Form 10-K for the year ended December 31, 2015, along with any supplements in Part II below, and various disclosures in our press releases, stockholder reports, and other filings with the Securities and Exchange Commission.

All such forward-looking statements speak only as of the date of this Form 10-Q. You are cautioned not to place undue reliance on such forward-looking statements. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in the events, conditions, or circumstances on which any such statement is based.

### Introduction

### Business Overview

We offer a broad range of full truckload transportation and logistics services with one of North America's largest tractor fleets, operated through a nationwide network of service centers, and contractual access to thousands of third-party capacity providers. We have grown substantially by increasing the geographic reach of our service center network and by expanding the breadth of our services for customers. Our Trucking segment provides truckload transportation, including dedicated services, of various products, goods, and materials for our diverse customer base through our Dry Van, Refrigerated, and Drayage operating units. The Brokerage and Intermodal operating units of our Logistics segment provide a multitude of shipment solutions, including additional sources of truckload capacity and alternative transportation modes, by utilizing our vast network of third-party capacity providers and rail providers, as well as certain logistics, freight management, and other non-trucking services. Our objective is to operate our Trucking and Logistics business with industry-leading margins and growth while providing safe, high-quality, cost-effective solutions for our customers.

Factors that affect our results of operations are industry-wide economic factors, such as freight demand, truckload and rail intermodal capacity, fuel prices, inventory levels, industrial production, government regulation, and unemployment rates, as well as our capital allocation, sales and marketing, operating, and spending decisions. We measure our results through key metrics, such as the number of tractors we operate, our revenue per tractor (which includes primarily our revenue per total mile and our number of miles per tractor), freight volumes brokered to third-party capacity providers (including our rail partners), driver and independent contractor recruitment and retention, and our ability to control costs on a company-wide basis, as measured by cost per mile in our Trucking

segment and non-GAAP operating ratio in both segments. Our success depends on our ability to efficiently and effectively manage our resources in providing transportation and logistics solutions to our customers in light of such factors. We evaluate the growth opportunities for each of our Trucking and Logistics businesses based on customer demand and supply chain trends, availability of drivers and third-party capacity providers, expected returns on invested capital, expected net cash flows, and our company-specific capabilities.

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Recent Consolidated Results of Operations and Quarter-End Financial Condition

Our consolidated results of operations for the three months ended September 30, 2016, compared to the three months ended September 30, 2015, were as follows:

Total revenue decreased 6.5%, to \$280.5 million from \$300.1 million;

Revenue, before fuel surcharge, decreased 5.1%, to \$256.2 million from \$269.9 million;

Net income attributable to Knight Transportation decreased 22.9%, to \$23.4 million from \$30.3 million; and

Net earnings attributable to Knight Transportation per diluted share decreased to \$0.29 per share from \$0.37 per share.

The freight environment remained modest in the third quarter of 2016 compared to the same quarter in the prior year. We continued to experience excess trucking capacity with fewer non-contract opportunities that pressured our revenue per loaded mile as compared to last year. However, we sustained improvement in our asset utilization and experienced more favorable freight conditions as the quarter progressed. Although an environment of surplus trucking capacity continues, we are encouraged by current freight volumes and asset utilization and expect capacity to continue to tighten in the next few quarters as signaled by significantly declining new truck orders, the weak used equipment market, increased bankruptcies, reduction in the driver workforce, broker margin compression, inflationary driver pay and additional regulatory burdens expected to phase in over the coming quarters.

During the third quarter of 2016, our Trucking segment produced a non-GAAP operating ratio of 83.1% compared to 79.8% in the same quarter of 2015, while trucking revenue, excluding trucking fuel surcharge, decreased 3.6% in the quarter year over year. Please see the reconciliation table below for a reconciliation of GAAP operating ratio to non-GAAP operating ratio. Productivity, as measured by average revenue per tractor, before fuel surcharge, decreased 0.8% in the third quarter of 2016 compared to the same quarter of 2015, attributable to a 2.1% decrease in average revenue per loaded mile, and an increase in non-paid empty mile percentage of 30 basis points, partially offset by a 1.6% increase in average miles per tractor.

Our Logistics segment produced an operating ratio of 95.2% in the third quarter of 2016 compared to 93.6% for the same quarter in 2015, with revenue declining 10.6%. The decrease in revenue is attributable primarily to a decline in non-trucking service revenue in the third quarter of 2016 from the same quarter of 2015, as we exited our agricultural sourcing business in the first quarter of 2016. Revenue from our Brokerage business, the largest component of our Logistics segment, also decreased in the third quarter of 2016 compared to the same quarter of 2015 by 4.5%. Despite Brokerage revenue decreasing, Brokerage load volume increased 7.0%. The decrease in Brokerage revenue was a result of lower fuel surcharge, a shorter length of haul, and lower non-contract pricing. Brokerage gross margins contracted 140 basis points in the quarter as capacity began to tighten.

In the third quarter of 2016, we returned \$8.1 million to our shareholders in the form of quarterly cash dividends and stock repurchases and ended the quarter with \$764.6 million of shareholders' equity. In the third quarter of 2016, we generated \$55.6 million in cash flow from operations and used \$40.7 million for capital expenditures net of equipment sales.

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Our liquidity is not materially affected by off-balance sheet transactions. See the discussion under "Off-Balance Sheet Transactions" and "Liquidity and Capital Resources" for a description of our off-balance sheet transactions.

## Consolidated Revenue and Expenses

We primarily generate revenue by transporting freight for our customers in our Trucking segment or arranging for the transportation of customer freight in our Logistics segment. Our total revenue is reported under "Results of Operations" and categorized as (i) Trucking revenue, before fuel surcharge, (ii) Trucking fuel surcharge revenue, and (iii) Logistics revenue. Trucking revenue, before fuel surcharge, and Trucking fuel surcharge revenue is largely generated by the trucking services provided by our three Trucking operating units (Dry Van, Refrigerated, and Drayage) whereas Logistics revenue is mostly generated by the logistics services provided by our two Logistics operating units (Brokerage and Intermodal). We also provide logistics, freight management, sourcing, and other non-trucking services, such as used equipment sales and leasing to independent contractors and third-parties, through our Logistics business.

The total revenue and operating expenses of our Trucking and Logistics segments are similarly affected by certain factors that generally relate to, among other things, overall economic and weather conditions in the United States, customer inventory levels, specific customer demand, the levels of truckload and rail intermodal capacity, and availability of qualified drivers, independent contractors, and third-party capacity providers. See the section entitled "Item 1A. Risk Factors," set forth in our Form 10-K for the year ended December 31, 2015, along with various disclosures in our press releases, shareholder reports, and other filings with the Securities and Exchange Commission.

To reduce our risk to fuel price fluctuations in our Trucking segment, we have a fuel surcharge program under which we obtain additional fuel surcharges from our customers that generally recover a majority, but not all, of the increased fuel costs; however, we cannot ensure that current recovery levels will continue in the future. In discussing our overall and segment-based results of operations, because changes in fuel costs typically cause fuel surcharge revenue to fluctuate, we identify Trucking fuel surcharge revenue separately and omit fuel surcharge revenue from our statistical calculations. We believe that omitting this potentially volatile source of revenue provides a more meaningful comparison of our operating results from period to period.

A primary measure we use to evaluate the profitability of our overall and segment based operations is operating ratio, measured both on a GAAP basis (operating expenses expressed as a percentage of revenue) and on a non-GAAP basis ("non-GAAP operating ratio") that many in our industry use (operating expenses, net of Trucking fuel surcharge revenue, expressed as a percentage of Trucking revenue, excluding Trucking fuel surcharge revenue). We believe the second method allows us to more effectively compare periods while excluding the potentially volatile effect of changes in fuel prices. Non-GAAP operating ratio is not a substitute for or superior to, and should be considered in addition to, GAAP operating ratio. Pursuant to the requirements of Regulation G, the tables below compare our operating ratio using both methods on a consolidated basis.

The following table reconciles consolidated GAAP operating ratio to consolidated non-GAAP operating ratio (dollars in thousands):

|                          | Three Months Ended September 30, 2016 |      | Three Months Ended September 30, 2015 |      | Nine Months Ended September 30, 2016 |      | Nine Months Ended September 30, 2015 |      |
|--------------------------|---------------------------------------|------|---------------------------------------|------|--------------------------------------|------|--------------------------------------|------|
| GAAP Presentation:       | \$                                    | %    | \$                                    | %    | \$                                   | %    | \$                                   | %    |
| Total revenue            | \$280,530                             |      | \$300,122                             |      | \$828,936                            |      | \$892,225                            |      |
| Total operating expenses | 243,596                               | 86.8 | 253,696                               | 84.5 | 715,194                              | 86.3 | 757,877                              | 84.9 |

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|                        |        |          |         |           |
|------------------------|--------|----------|---------|-----------|
| Income from operations | 36,934 | \$46,426 | 113,742 | \$134,348 |
|------------------------|--------|----------|---------|-----------|

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|   | Three Months<br>Ended<br>September 30,<br>2016 |      | Three Months<br>Ended<br>September 30,<br>2015 |      | Nine Months<br>Ended<br>September 30,<br>2016 |      | Nine Months<br>Ended<br>September 30,<br>2015 |      |
|---|--|------|--|------|---|------|---|------|
| Non-GAAP Presentation <sup>(1)</sup> :          | \$   | %    | \$   | %    | \$  | %    | \$  | %    |
| Total revenue                                   | \$280,530                                      |      | \$300,122                                      |      | \$828,936                                     |      | \$892,225                                     |      |
| Less fuel surcharge                             | (24,287 )                                      |      | (30,192 )                                      |      | (65,252 )                                     |      | (96,458 )                                     |      |
| Revenue, before fuel surcharge                  | 256,243  |      | 269,930  |      | 763,684                                       |      | 795,767                                       |      |
| Total operating expenses                        | 243,596  |      | 253,696  |      | 715,194                                       |      | 757,877                                       |      |
| Less fuel surcharge                             | (24,287 )                                      |      | (30,192 )                                      |      | (65,252 )                                     |      | (96,458 )                                     |      |
| Total operating expenses, net of fuel surcharge | 219,309  | 85.6 | 223,504  | 82.8 | 649,942                                       | 85.1 | 661,419                                       | 83.1 |
| Income from operations                          | 36,934   |      | 46,426   |      | 113,742                                       |      | 134,348                                       |      |

<sup>(1)</sup> These items represent non-GAAP financial measures and are not substitutes for or superior to, and should be considered in addition to, the GAAP financial measures presented in the previous table.

The following table sets forth revenue and operating income between the Trucking and Logistics segments for the three months and nine months ended September 30, 2016 and 2015 (dollars in thousands).

|                                     | Three Months<br>Ended<br>September 30,<br>2016 |       | Three Months<br>Ended<br>September 30,<br>2015 |       | Nine Months<br>Ended<br>September 30,<br>2016 |       | Nine Months<br>Ended<br>September 30,<br>2015 |       |
|-------------------------------------|--|-------|--|-------|---|-------|---|-------|
| <u>Revenues:</u>                    | \$   | %     | \$   | %     | \$  | %     | \$  | %     |
| Trucking Segment                    | \$228,590                                      | 81.5  | \$242,046                                      | 80.6  | \$672,969                                     | 81.2  | \$722,963                                     | 81.0  |
| Logistics Segment                   | 53,643   | 19.1  | 62,773   | 20.9  | 163,955                                       | 19.8  | 181,339                                       | 20.3  |
| Subtotal                            | 282,233  |       | 304,819  |       | 836,924                                       |       | 904,302                                       |       |
| Intersegment Eliminations Trucking  | (34 )  | 0.0   | (38 )  | 0.0   | (106 )  | 0.0   | (116 )  | 0.0   |
| Intersegment Eliminations Logistics | (1,669 )                                       | (0.6) | (4,659 )                                       | (1.5) | (7,882 )                                      | (1.0) | (11,961 )                                     | (1.3) |
| Total                               | \$280,530                                      | 100 % | \$300,122                                      | 100 % | \$828,936                                     | 100 % | \$892,225                                     | 100 % |
| <u>Operating Income:</u>            |  |       |  |       |   |       |   |       |
| Trucking Segment                    | \$34,439                                       | 93.2  | \$42,710                                       | 92.0  | \$105,647                                     | 92.9  | \$122,800                                     | 91.4  |
| Logistics Segment                   | 2,495  | 6.8   | 3,716  | 8.0   | 8,095   | 7.1   | 11,548  | 8.6   |
| Total                               | \$36,934                                       | 100 % | \$46,426                                       | 100 % | \$113,742                                     | 100 % | \$134,348                                     | 100 % |

## Trucking Strategy and Segment Information

Our Trucking operating strategy is to achieve a high level of asset utilization within a highly disciplined operating system while maintaining strict controls over our cost structure. To achieve these goals, we operate primarily in high-density, predictable freight lanes in select geographic regions and attempt to develop and expand our customer base around each of our service centers by providing multiple truckload services for each customer. This operating strategy allows us to take advantage of the large amount of freight transported in regional markets. Our service centers enable us to better serve our customers and work more closely with our driving associates. We operate a premium, modern fleet to appeal to drivers and customers, reduce maintenance expenses and driver and equipment downtime, and enhance our fuel and other operating efficiencies. We employ technology in a cost-effective manner to assist us in controlling operating costs and in enhancing revenue.



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Trucking revenue is generated by our Dry Van, Refrigerated, and Drayage operating units. Generally, we are paid a predetermined rate per mile or per load for our Trucking services. Additional revenues are generated by charging for tractor and trailer detention, loading and unloading activities, dedicated services, and other specialized services, as well as through the collection of fuel surcharges to mitigate the impact of increases in the cost of fuel. The main factors that affect our Trucking revenue are the revenue per mile we receive from our customers, the percentage of miles for which we are compensated, and the number of loaded miles we generate with our equipment.

Effectively controlling our expenses is an important element of maximizing our profitability. The most significant expenses of our Trucking segment are primarily variable and include fuel and fuel taxes, driver-related expenses (such as wages, benefits, training, and recruitment) and costs associated with independent contractors (which are primarily included in purchased transportation expense recorded on the "Purchased transportation" line in the accompanying condensed consolidated statements of income). Expenses that have both fixed and variable components include maintenance expense (which includes costs for replacement tires for our revenue equipment) and our total cost of insurance and claims. These expenses generally vary with the miles we travel but also have a controllable component based on safety, fleet age, efficiency, and other factors. The main fixed costs for our Trucking segment are the acquisition and depreciation of long-term assets (such as revenue equipment and service centers) and the compensation of non-driver personnel.

The primary measure we use to evaluate the profitability of our Trucking segment is operating ratio, measured both on a GAAP basis (operating expenses expressed as a percentage of revenue) and on a non-GAAP basis that many in our industry use (operating expenses, net of Trucking fuel surcharge revenue, expressed as a percentage of Trucking revenue, excluding Trucking fuel surcharge revenue). We believe the second method allows us to more effectively compare periods while excluding the potentially volatile effect of changes in fuel prices. Non-GAAP operating ratio is not a substitute for or superior to, and should be considered in addition to, GAAP operating ratio. Pursuant to the requirements of Regulation G, the tables below compare our operating ratio using both methods.

The following table sets forth the Trucking segment operating ratio on a GAAP basis (dollars in thousands).

|                           | Three Months Ended September 30, 2016 |      | Three Months Ended September 30, 2015 |      | Nine Months Ended September 30, 2016 |      | Nine Months Ended September 30, 2015 |      |
|---------------------------|---------------------------------------|------|---------------------------------------|------|--------------------------------------|------|--------------------------------------|------|
| <u>GAAP Presentation:</u> |                                       |      |                                       |      |                                      |      |                                      |      |
| Trucking Segment Revenue  | \$                                    | %    | \$                                    | %    | \$                                   | %    | \$                                   | %    |
| Operating expenses        | 228,590                               | 84.9 | 242,046                               | 82.4 | 672,969                              | 84.3 | 722,963                              | 83.0 |
| Operating income          | \$34,439                              |      | \$42,710                              |      | \$105,647                            |      | \$122,800                            |      |



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The following table sets forth the non-GAAP operating ratio for our Trucking segment as if fuel surcharges are excluded from total revenue and instead reported as a reduction of operation expenses, excluding intersegment activity (dollars in thousands).

|   | Three Months<br>Ended<br>September 30,<br>2016 |      | Three Months<br>Ended<br>September 30,<br>2015 |      | Nine Months<br>Ended<br>September 30,<br>2016 |      | Nine Months<br>Ended<br>September 30,<br>2015 |      |
|---|--|------|--|------|---|------|---|------|
| <u>Non-GAAP Presentation</u> <sup>(1)</sup> :                           |  |      |  |      |   |      |   |      |
| Trucking Segment  | \$   | %    | \$   | %    | \$  | %    | \$  | %    |
| Revenue   | \$228,590                                      |      | \$242,046                                      |      | \$672,969                                     |      | \$722,963                                     |      |
| Less: Trucking fuel surcharge revenue                                   | (24,287 )                                      |      | (30,192 )                                      |      | (65,252 )                                     |      | (96,458 )                                     |      |
| Less: Intersegment transactions   | (34 )  |      | (38 )  |      | (106 )  |      | (116 )  |      |
| Revenue, net of fuel surcharge and intersegment transactions            | 204,269  |      | 211,816  |      | 607,711                                       |      | 626,389                                       |      |
| Operating expenses  | 194,151  |      | 199,336  |      | 567,322                                       |      | 600,163                                       |      |
| Less: Trucking fuel surcharge revenue                                   | (24,287 )                                      |      | (30,192 )                                      |      | (65,252 )                                     |      | (96,458 )                                     |      |
| Less: Intersegment transactions   | (34 )  |      | (38 )  |      | (106 )  |      | (116 )  |      |
| Operating expenses, net of fuel surcharge and intersegment transactions | 169,830  | 83.1 | 169,106  | 79.8 | 501,964                                       | 82.6 | 503,589                                       | 80.4 |
| Operating income  | \$34,439                                       |      | \$42,710                                       |      | \$105,647                                     |      | \$122,800                                     |      |

<sup>(1)</sup> These items represent non-GAAP financial measures and are not substitutes for or superior to, and should be considered in addition to, the GAAP financial measures presented in the previous table.

When evaluating Trucking revenue, we consider the following key operating statistics for each period: (i) average revenue per tractor; (ii) average length of haul (miles with loaded trailer cargo); (iii) non-paid empty miles percent (miles without trailer cargo); and (iv) average number of tractors and trailers in operation. The following table sets forth key operating statistics of the Trucking segment for the indicated periods.

|   | Three<br>Months<br>Ended<br>September<br>30, 2016 |   | Three<br>Months<br>Ended<br>September<br>30, 2015 |   | Nine<br>Months<br>Ended<br>September<br>30, 2016 |   | Nine<br>Months<br>Ended<br>September<br>30, 2015 |   |
|---|---|---|---|---|--|---|--|---|
| Average revenue per tractor <sup>(1)</sup>  | \$ 43,501   |   | \$ 43,863   |   | \$ 129,444                                       |   | \$ 130,398                                       |   |
| Average length of haul (miles)              | 500   |   | 505   |   | 500  |   | 505  |   |
| Non-paid empty mile percent                 | 12.4  | % | 12.1  | % | 12.4   | % | 11.7   | % |
| Average tractors in operation during period | 4,696   |   | 4,829   |   | 4,694  |   | 4,804  |   |
| Average trailers in operation during period | 12,325  |   | 12,021  |   | 12,194   |   | 11,668   |   |

<sup>(1)</sup> Average revenue per tractor is based on trucking revenue, net of intersegment elimination, and does not include fuel surcharge revenue.

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Our Trucking segment requires substantial capital expenditures for purchases of new revenue equipment. We fund these purchases with cash flows from operations and financing available under our existing line of credit. We operated an average of 4,696 tractors in the third quarter of 2016, of which 4,282 were company-owned tractors as of September 30, 2016. The average age of our company-owned tractor fleet was 2.0 years in the quarter ended September 30, 2016. We also operated an average of 12,325 trailers in the third quarter of 2016, with an average age of 3.9 years. Our net property, plant, and equipment at September 30, 2016, was \$813.2 million, most of which relates to our Trucking segment.

Our capital expenditures can also affect depreciation expense. Trucking depreciation relates primarily to our owned tractors, trailers, electronic logging devices and other communication units, and other similar assets. Changes to this fixed cost are generally attributed to increases or decreases to company-owned equipment and fluctuations in new equipment purchase prices, which have historically been precipitated in part by new or proposed federal and state regulations (such as the EPA engine emissions requirements relating to post-2014 model tractors and the California trailer efficiency requirements). Depreciation can also be affected by the cost of used equipment that we sell or trade and the replacement of older used equipment. Our management periodically reviews the condition, average age, and reasonableness of estimated useful lives and salvage values of our equipment and considers such factors in light of our experience with similar assets, used equipment market conditions, and prevailing industry practice. Total Trucking segment depreciation and amortization expense was approximately \$28.0 million in the third quarter of 2016, and approximately \$83.4 million in the first nine months of 2016.

Logistics Strategy and Segment Information

Logistics revenue is generated primarily by our Brokerage and Intermodal operating units. We also provide logistics, freight management and other non-trucking services to our customers through our Logistics business. We are generally paid a predetermined rate per mile or per load for arranging freight transportation for our customers and providing other Logistics services. Additional revenue is generated by offering specialized logistics solutions (including, but not limited to, origin management, surge volumes, disaster relief, special projects, and other logistics needs). Our Logistics revenue is mainly affected by the rates we obtain from customers, the freight volumes we ship through our third-party capacity providers, and our ability to secure qualified third-party capacity providers to transport customer freight.

Our Logistics segment is less asset-intensive and is instead dependent upon capable non-driver personnel, modern and effective information technology, and qualified third-party capacity providers. The most significant expense of our Logistics segment, which is primarily variable, is the cost of purchased transportation that we pay to third-party capacity providers (including our rail providers), which is included in the "Purchased transportation" line in the accompanying condensed consolidated statements of income. This expense generally varies depending upon truckload and rail capacity, availability of third-party capacity providers, rates charged to customers, and current freight demand and customer shipping needs. Other Logistics operating expenses are generally fixed and primarily include the compensation and benefits of non-driver personnel (included in salaries, wages and benefits expense recorded on the "Salaries, wages and benefits" line in the accompanying condensed consolidated statements of income) and depreciation and amortization expense.

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The following table sets forth the Logistics segment revenue, operating expenses, and operating income (dollars in thousands).

|                    | Three Months Ended September 30, 2016 |      | Three Months Ended September 30, 2015 |      | Nine Months Ended September 30, 2016 |      | Nine Months Ended September 30, 2015 |      |
|--------------------|---------------------------------------|------|---------------------------------------|------|--------------------------------------|------|--------------------------------------|------|
| Logistics Segment  | \$                                    | %    | \$                                    | %    | \$                                   | %    | \$                                   | %    |
| Revenue            | \$53,643                              |      | \$62,773                              |      | \$163,955                            |      | \$181,339                            |      |
| Operating expenses | 51,148                                | 95.3 | 59,057                                | 94.1 | 155,860                              | 95.1 | 169,791                              | 93.6 |
| Operating income   | \$2,495                               |      | \$3,716                               |      | \$8,095                              |      | \$11,548                             |      |

The following table sets forth the Logistics segment revenue, operating expenses, and operating income, excluding intersegment transactions (dollars in thousands).

|  | Three Months Ended September 30, 2016 |      | Three Months Ended September 30, 2015 |      | Nine Months Ended September 30, 2016 |      | Nine Months Ended September 30, 2015 |      |
|--|---------------------------------------|------|---------------------------------------|------|--------------------------------------|------|--------------------------------------|------|
| Logistics Segment                                      | \$                                    | %    | \$                                    | %    | \$                                   | %    | \$                                   | %    |
| Revenue  | \$53,643                              |      | \$62,773                              |      | \$163,955                            |      | \$181,339                            |      |
| Less: Intersegment transactions                        | (1,669)                               |      | (4,659)                               |      | (7,882)                              |      | (11,961)                             |      |
| Revenue excluding intersegment transactions            | 51,974                                |      | 58,114                                |      | 156,073                              |      | 169,378                              |      |
| Operating expenses                                     | 51,148                                |      | 59,057                                |      | 155,860                              |      | 169,791                              |      |
| Less: Intersegment transactions                        | (1,669)                               |      | (4,659)                               |      | (7,882)                              |      | (11,961)                             |      |
| Operating expenses excluding intersegment transactions | 49,479                                | 95.2 | 54,398                                | 93.6 | 147,978                              | 94.8 | 157,830                              | 93.2 |
| Operating income                                       | \$2,495                               |      | \$3,716                               |      | \$8,095                              |      | \$11,548                             |      |

We primarily measure the Logistics segment's profitability by reviewing the gross margin percentage (revenue net of intersegment elimination, less purchased transportation expense, expressed as a percentage of revenue, net of intersegment elimination) and the operating ratio. The gross margin percentage can be affected by customer rates and the costs of securing third-party capacity providers. Our third-party capacity providers generally are not subject to long-term or predetermined contracted rates, and our operating results could be affected if the availability of third-party capacity providers or the rates for such providers change in the future. The following table lists the gross margin percentage for our Brokerage and Intermodal businesses combined.

|   | Three Months Ended September 30, 2016 | Three Months Ended September 30, 2015 | Nine Months Ended September 30, 2016 | Nine Months Ended September 30, 2015 |
|---|---------------------------------------|---------------------------------------|--------------------------------------|--------------------------------------|
| Combined Brokerage and Intermodal gross margin percent <sup>(1)</sup> | 14.4%                                 | 16.0%                                 | 16.5%                                | 16.1%                                |

<sup>(1)</sup>Gross margin percentage is based on revenue net of intersegment elimination.

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Our Logistics segment does not require significant capital expenditures and is not asset-intensive like our Trucking segment. Rather, our Logistics segment depends on effective usage of information systems and technology that enable us to efficiently arrange for the transportation of our customers' freight and remain resourceful and responsive in meeting customer shipping needs. As our Logistics services evolve, we may incur costs to upgrade, integrate, or expand our information systems and technology. Total Logistics segment depreciation and amortization expense was approximately \$1.1 million in the third quarter of 2016, and \$3.1 million in the first nine months of 2016, which is primarily attributed to equipment leased to third parties.

### Trends and Outlook

We are encouraged by the freight volumes and asset utilization we have seen at the end of the third quarter and early part of the fourth quarter of 2016. Several positive market indicators suggest we can expect a more favorable freight environment and normal seasonal trends through the end of the year. We believe excess capacity will continue to exit the market, as indicated by significantly declining new truck orders, the weak used equipment market, increased bankruptcies, reduction in driver workforce, broker margin compression, inflationary driver pay, and additional regulatory burdens expected to phase in over the coming quarters. Market factors including higher driver wages, lower gain on sale of revenue equipment, less other income, and fewer non-contract opportunities may continue to negatively affect our margins in our Trucking and Logistics segments if capacity is slow to exit the market. We plan to limit organic fleet expansion until we see meaningful rate improvement and increased customer demand, while focusing on cost control, and allocating expansion capital toward Logistics.

Our driver development program remains a primary focus for our management team. We believe carriers that are well-positioned to develop and retain drivers, withstand supply and demand fluctuations, and provide safe, dependable, and high-quality service to customers will have opportunities to increase freight rates and market share. We believe domestic and global economic and political conditions present the most direct challenges to improved freight demand. These threats include the possibility that rising energy prices, an inability of the United States government to timely and adequately address fiscal issues, currency fluctuations, or other factors outside our control could reduce consumer spending or industrial investment, thus negatively affecting freight volumes.

Several issues impacting the trucking industry could also cause our costs to increase for the remainder of 2016. These issues include driver and independent contractor availability, fuel price fluctuations, increases to new tractor and trailer purchase prices, and compliance with new and proposed federal and state regulations. From a cost perspective, recruiting and retaining sufficient numbers of qualified drivers, independent contractors, and third-party capacity providers may become increasingly costly, equipment prices may continue to rise, and potentially higher fuel prices may not be fully offset by fuel surcharges. In the current economic and regulatory environments, it will be important to allocate equipment to more compensatory shipments, use technology to generate efficiencies, continue to grow our Logistics segment, and effectively manage fuel and other costs. We believe we have the service center network, modern tractor fleet, comprehensive truckload and logistics services, management team and qualified personnel, technology, intense focus on cost control, and capital resources to successfully overcome these challenges and capitalize on future opportunities.

We expect to utilize the flexibility of our model to react and adapt to market conditions. We believe we can optimize our model and refine our execution in reaction to, or in anticipation of, transportation market dynamics, particularly the markets for truckload and logistics services that we offer. We plan to continue to evaluate acquisition candidates and other opportunities that create value for our shareholders and further advance our long-term strategy.

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## Results of Operations

The following table sets forth the consolidated statements of income in dollars and as a percentage of total revenue and the percentage increase or decrease in the dollar amounts of those items compared to the prior year (dollars in thousands).

|   | Three Months Ended September 30, 2016 |        | Three Months Ended September 30, 2015 |        | % Change | Nine Months Ended September 30, 2016 |        | Nine Months Ended September 30, 2015 |        | % Change |
|---|---------------------------------------|--------|---------------------------------------|--------|----------|--------------------------------------|--------|--------------------------------------|--------|----------|
|   | \$                                    | %      | \$                                    | %      |          | \$                                   | %      | \$                                   | %      |          |
| Trucking revenue                        | \$204,269                             | 72.8 % | \$211,816                             | 70.6 % | (3.6 %)  | \$607,611                            | 73.3 % | \$626,389                            | 70.2 % | (3.0 %)  |
| Trucking fuel surcharge revenue         | 24,287                                | 8.7    | 30,192                                | 10.1   | (19.6)   | 65,252                               | 7.9    | 96,458                               | 10.8   | (32.4)   |
| Logistics revenue                       | 51,974                                | 18.5   | 58,114                                | 19.3   | (10.6)   | 156,073                              | 18.8   | 169,378                              | 19.0   | (7.9 )   |
| Total revenue                           | 280,530                               | 100.0  | 300,122                               | 100.0  | (6.5 )   | 828,936                              | 100    | 892,225                              | 100.0  | (7.1 )   |
| Operating expenses:                     |                                       |        |                                       |        |          |                                      |        |                                      |        |          |
| Salaries, wages and benefits            | 82,688                                | 29.5   | 85,514                                | 28.5   | (3.3 )   | 250,732                              | 30.3   | 249,921                              | 28.0   | 0.3      |
| Fuel                                    | 34,616                                | 12.3   | 39,795                                | 13.2   | (13.0)   | 94,815                               | 11.4   | 120,247                              | 13.5   | (21.1)   |
| Operations and maintenance              | 19,781                                | 7.1    | 20,390                                | 6.8    | (3.0 )   | 56,886                               | 6.9    | 62,065                               | 7.0    | (8.3 )   |
| Insurance and claims                    | 9,251                                 | 3.3    | 8,149                                 | 2.7    | 13.5     | 26,330                               | 3.2    | 25,076                               | 2.8    | 5.0      |
| Operating taxes and licenses            | 4,546                                 | 1.6    | 3,373                                 | 1.1    | (34.8)   | 14,645                               | 1.7    | 13,954                               | 1.5    | 5.0      |
| Communications                          | 976                                   | 0.4    | 849                                   | 0.3    | 15.0     | 3,224                                | 0.4    | 3,066                                | 0.3    | 5.2      |
| Depreciation and amortization           | 29,129                                | 10.4   | 28,204                                | 9.4    | 3.3      | 86,486                               | 10.4   | 82,728                               | 9.3    | 4.5      |
| Purchased transportation <sup>(1)</sup> | 57,069                                | 20.3   | 62,115                                | 20.7   | (8.1 )   | 168,772                              | 20.4   | 182,279                              | 20.4   | (7.4 )   |
| Miscellaneous operating expenses        | 5,540                                 | 1.9    | 5,307                                 | 1.8    | 4.4      | 13,304                               | 1.6    | 18,541                               | 2.1    | (28.2)   |
| Total operating expenses                | 243,596                               | 86.8   | 253,696                               | 84.5   | (4.0 )   | 715,194                              | 86.3   | 757,877                              | 84.9   | (5.6 )   |
| Operating income                        | 36,934                                | 13.2   | 46,426                                | 15.5   | (20.4)   | 113,742                              | 13.7   | 134,348                              | 15.1   | (15.3)   |
| Interest income                         | 83                                    | 0.0    | 140                                   | 0.0    | (40.7)   | 259                                  | 0.0    | 377                                  | 0.0    | (31.3)   |
| Interest expense                        | (182 )                                | (0.1 ) | (220 )                                | (0.1 ) | (17.3)   | (742 )                               | (0.1 ) | (714 )                               | (0.1 ) | 3.9      |
| Other income                            | 1,389                                 | 0.5    | 2,335                                 | 0.8    | (40.5)   | 4,602                                | 0.6    | 7,234                                | 0.8    | (36.4)   |
| Total other income                      | 1,290                                 | 0.4    | 2,255                                 | 0.7    | (42.8)   | 4,119                                | 0.5    | 6,897                                | 0.7    | (40.3)   |
|   | 38,224                                | 13.6   | 48,681                                | 16.2   | (21.5)   | 117,861                              | 14.2   | 141,245                              | 15.8   | (16.6)   |

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|  |          |        |          |        |         |          |        |          |        |         |  |
|--|----------|--------|----------|--------|---------|----------|--------|----------|--------|---------|--|
| Income before income taxes                         |          |        |          |        |         |          |        |          |        |         |  |
| Income taxes                                       | 14,558   | 5.2    | 17,946   | 6.0    | (18.9)  | 46,202   | 5.6    | 52,379   | 5.9    | (11.8)  |  |
| Net income   | \$23,666 | 8.4 %  | \$30,735 | 10.2 % | (23.0%) | \$71,659 | 8.6 %  | \$88,866 | 9.9 %  | (19.4%) |  |
| Net income attributable to noncontrolling interest | (316 )   | (0.1 ) | (452 )   | (0.1 ) | (30.1)  | (1,064 ) | (0.1 ) | (1,382 ) | (0.1 ) | (23.0)  |  |
| Net income attributable to Knight Transportation   | \$23,350 | 8.3 %  | \$30,283 | 10.1 % | (22.9%) | \$70,595 | 8.5 %  | \$87,484 | 9.8 %  | (19.3%) |  |

Purchased transportation expense is comprised of (a) payments to independent contractors, which is primarily (1) attributed to our Trucking segment; (b) payments to third-party capacity providers, which is primarily attributed to our Logistics segment; and (c) payments relating to our logistics, freight management and non-trucking services.

A discussion of our results of operations for the three months and nine months ended September 30, 2016 and September 30, 2015, is set forth below.

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Comparison of Three Months and Nine Months Ended September 30, 2016 to Three and Nine Months Ended September 30, 2015.

## Operating Revenue

Total revenue decreased 6.5% and 7.1% for the three months and nine months ended September 30, 2016, respectively, or to \$280.5 million from \$300.1 million in the three-month period, and to \$828.9 million from \$892.2 million in the nine-month period compared to the same periods of 2015. During the third quarter and nine-month period of 2016, we operated in a more challenging freight environment when compared to the same periods of 2015. Both our Trucking and Logistics segments experienced a moderate freight market where contract pricing remained depressed and non-contract opportunities were limited, when compared to the prior year periods, which combined with fewer trucks, lower fuel surcharge revenue and less non-trucking services revenue, led to the decline in total revenue.

Trucking revenue decreased 3.6% to \$204.3 million for the three months ended September 30, 2016, from \$211.8 million for the same three months in 2015, and 3.0% to \$607.6 million for the nine months ended September 30, 2016, from \$626.4 million for the same nine months in 2015. Tractor productivity, as measured by average revenue, before fuel surcharge, per tractor, decreased 0.8% for the three months ended September 30, 2016, and 0.7% for the nine months ended September 30, 2016, compared to the same periods in 2015. Although average miles per tractor increased 1.6% and 1.7% in the three months and nine months ended September 30, 2016, respectively, compared to the same periods of 2015, these improvements were offset by decreases in average revenue per loaded mile by 2.1% and 1.6%, respectively, and increases in non-paid empty mile percent of 30 and 70 basis points, respectively, in the same three-month and nine-month periods. We plan to limit organic fleet growth and remain focused on improving the productivity of our assets while developing our freight network. If capacity tightens, as we expect, we believe rates will begin to improve. However, any adverse changes in capacity, among other factors, could prevent rate increases and negatively affect existing rates.

Trucking fuel surcharge revenue decreased 19.6% to \$24.3 million in the third quarter of 2016, from \$30.2 million in the same quarter of 2015, and decreased 32.4% to \$65.3 million in the nine months ended September 30, 2016 from \$96.5 million in the same nine months in 2015. Typical fuel surcharge programs involve a computation based on the change in national or regional fuel prices. These programs may update as often as weekly, but typically require a specified minimum change in fuel cost to prompt a change in fuel surcharge revenue for our Trucking segment. Therefore, many of these programs have a time lag between when fuel costs change and when the change is reflected in fuel surcharge revenue for our Trucking segment. The U.S. National Average Diesel Fuel Price decreased in the three months and nine months ended September 30, 2016, by 9.4% and 19.6%, respectively, from the same periods of 2015. The decrease in Trucking fuel surcharge revenue is primarily due to the decrease in average fuel prices in both periods.

Logistics revenue decreased 10.6% to \$52.0 million in the third quarter of 2016, from \$58.1 million in the same quarter of 2015, and decreased 7.9% to \$156.1 million in the nine months ended September 30, 2016, from \$169.4 million in the nine months ended September 30, 2015. Logistics revenue decreased primarily due to declining revenue from our non-trucking services as we exited our agricultural sourcing business in the first quarter of 2016, and in part due to lower revenue per load as a result of lower fuel surcharge. Revenue in our Brokerage business, which is the largest component of our Logistics segment, decreased in the three months and nine months ended September 30, 2016 compared to the same periods in 2015, however, we continued to see load volume growth in both periods. This load volume growth was offset by a shorter length of haul, and lower non-contract pricing. We achieved this growth by providing more capacity to our customers through our third-party carriers and rail providers.





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## Operating Expenses

Salaries, wages and benefits expense, as a percentage of total revenue, increased to 29.5% for the three months ended September 30, 2016 and 30.3% for the nine months ended September 30, 2016, compared to 28.5% for the three months ended September 30, 2015 and 28.0% for the nine months ended September 30, 2015. These increases in both the three months and nine months ended September 30, 2016 from the same periods in 2015 were primarily due to the decrease in total revenue, as a result of lower revenue per loaded mile. In addition, driver wages continue to be inflationary due to increases in driver base pay implemented in 2015. We believe that the driver market remains challenging and that several ongoing market factors, including the implementation of stricter regulations, has further reduced the pool of available drivers. We expect that driver pay will continue to be inflationary on a year-over-year basis based on the pay increases that were implemented in 2015. We expect to continue to develop strategies designed to attract and retain safe, high-quality driving associates, including investing in technology and service centers that improve the experience of drivers, and we believe we are well-positioned for further progress developing driving associates in the coming quarters.

Fuel expense, as a percentage of total revenue, decreased to 12.3% for the three months ended September 30, 2016, from 13.2% in same period in 2015, and decreased to 11.4% for the nine months ended September 30, 2016, from 13.5% in the same period of 2015. These decreases were primarily due to the U.S. National Average Diesel Fuel Price decreasing by 9.4% and 19.6% in the three and nine months ended September 30, 2016, respectively, compared to the same periods in 2015. Our fuel efficiency initiatives and driver training programs continue to contribute to managing this expense. Our fuel surcharge program helps to offset increases in fuel prices, but applies only to loaded miles and typically does not offset empty miles, idle time, and out of route miles driven. Typical fuel surcharge programs involve a computation based on the change in national or regional fuel prices. These programs may update as often as weekly, but typically require a specified minimum change in fuel cost to prompt a change in fuel surcharge revenue for our Trucking segment. Therefore, many of these programs have a time lag between when fuel costs change and when the change is reflected in fuel surcharge revenue for our Trucking segment. Due to this time lag, our fuel expense, net of fuel surcharge, negatively impacts our operating income during periods of sharply rising fuel costs and positively impacts our operating income during periods of falling fuel costs.

Operations and maintenance expense, as a percentage of total revenue, increased to 7.1% from 6.8% in the three months ended September 30, 2016, compared to the same period in 2015, and decreased to 6.9% from 7.0% for the nine months ended September 30, 2016, compared to the same period in 2015. Operations and maintenance expense consists of direct operating expense, maintenance, and tire expense. The increase in the three month period of 2016 is primarily due to the overall decrease in total revenue as a result of a lower rate per mile, combined with an increase in direct operating costs, specifically road expense and driver development and recruiting costs. In both the three month and nine month periods of 2016, our maintenance and tire costs decreased as a percentage of total revenue, before Trucking fuel surcharge, compared to the same periods of 2015 due to improved cost control measures. Direct operating expenses decreased as a percentage of total revenue, before Trucking fuel surcharge in the nine month period of 2016 due to lower operating supply costs and drayage related operating costs. We continue to experience tight driver market conditions and we expect the driver market to remain competitive in the remainder of 2016, which could negatively affect our recruiting costs.

Insurance and claims expense, as a percentage of total revenue, increased to 3.3% in the three months ended September 30, 2016 from 2.7% for the same period in 2015, and increased to 3.2% in the nine months ended September 30, 2016 from 2.8% for the same period in 2015. These increases were partly due to the decreases in total revenue in both periods of 2016 compared to the same periods of 2015, combined with slightly higher premium costs and changes in the severity of claims. Insurance and claims expense consists of premiums for liability, physical damage, and cargo, and will vary based upon the frequency and severity of claims, as well as our level of self-insurance, and premium expense.

Operating taxes and license expense, as a percentage of total revenue, increased to 1.6% and 1.7% for the three months and nine months ended September 30, 2016, respectively, from 1.1% and 1.5% for the three and nine months ended September 30, 2015, respectively. The increases in the three-month and nine-month periods were due in part to the overall decrease in revenue combined with an adjustment in 2015 to align our Barr-Nunn subsidiary fuel tax reporting with our other Trucking operating units. Decreases in license and registration costs were offset by increases in property tax expenses. This expense line is impacted by changes in various fuel tax rates and registration fees associated with our truck fleet and regional operating facilities.

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Communications expense, as a percentage of total revenue, increased slightly to 0.4% in the three months and nine months ended September 30, 2016 from 0.3% in the three months and nine months ended September 30, 2015. The increases were primarily due to the decrease in total revenue while the cost of these services increased slightly. Communications expense is comprised of costs associated with our tractor and trailer tracking systems, information technology systems, and phone systems.

Depreciation and amortization expense, as a percentage of total revenue, increased to 10.4% in the three months and nine months ended September 30, 2016 from 9.4% and 9.3% in the three months and nine months ended September 30, 2015, respectively. This fixed cost as a percentage of total revenue was higher for both the three months and nine months ended September 30, 2016, due to a combination of the decrease in fuel surcharge revenue driven by the fall in fuel prices, the decrease in revenue, before fuel surcharge, driven by the decrease in average revenue per tractor in our Trucking segment, and the decrease in revenue from our less asset-intensive Logistics segment. Depreciation and amortization expense for our Trucking segment as a percentage of Trucking revenue, before fuel surcharge, increased to 13.7% for the three and nine months ended September 30, 2016, from 12.8% for the same three months of 2015, and from 12.7% for the same nine months of 2015. These increases were in part due to the decrease in average revenue per tractor, rising new equipment prices, and an increase in our tractor to trailer ratio in both the three months and nine months ended September 30, 2016, compared to the same periods in 2015. With the rising equipment prices, and a continuing soft used equipment market, we have extended the expected trade cycle for our tractors which is expected to reduce capital expenditures and restrict higher depreciation and amortization costs in the future. In implementing the extended trade cycle, we have been proactive in managing our preventative maintenance program with a goal of mitigating the additional maintenance cost commonly associated with a slightly older fleet.

Purchased transportation expense, as a percentage of total revenue, decreased to 20.3% for the three months ended September 30, 2016 from 20.7% for the same three months in 2015, and remained flat at 20.4% for the nine months ended September 30, 2016 and 2015. Purchased transportation expense is comprised of (i) payments to independent contractors for our Dry Van, Refrigerated, and Drayage operations in our Trucking segment; (ii) payments to third-party capacity providers for our Brokerage operations and to railroads for our Intermodal operations; and (iii) payments relating to logistics, freight management and non-trucking services in our Logistics segment. Purchased transportation expense expressed as a percentage of total revenue, before fuel surcharge, decreased to 22.3%, and 22.1% in the three and nine months ended September 30, 2016, respectively, from 23.0%, and 22.9%, in the same periods of 2015, respectively. Purchased transportation expense expressed as a percentage of Trucking revenue, before fuel surcharge, for independent contractors in our Trucking segment increased in the three months ended September 30, 2016, and decreased in the nine months ended September 30, 2016, compared to the same periods of 2015. The increase in the three-month period was due to the decreases in revenue per loaded mile. The decrease in the nine-month period was primarily due to the decrease in fuel prices as purchased transportation costs generally take into account changes in diesel fuel prices, resulting in lower payments during periods of declining fuel prices. Purchased transportation expense decreased as expected with the decrease in revenue in our Logistics segment, but this decrease was hindered in the nine months ended September 30, 2016 by increased costs associated with exiting our agriculture sourcing business in the first quarter of 2016. We expect purchased transportation will increase as a percentage of total revenue if we are successful in continuing to grow our Logistics segment.

Miscellaneous operating expenses, as a percentage of total revenue, increased slightly to 1.9% for the three months ended September 30, 2016, from 1.8% for the same three months during 2015, and decreased to 1.6% for the nine months ended September 30, 2016, from 2.1% for the same nine months in 2015. The decrease in the nine month period was primarily due to the infrequent expense recorded in the second quarter of 2015 of \$7.2 million pretax (\$4.4 million after tax) relating to settlement costs for two class action lawsuits involving employment-related claims in California and Oregon. Excluding this infrequent expense, and excluding the effect of the decrease in the fuel surcharge component of total revenue, miscellaneous operating expenses increased in both the three months and Nine Months Ended September 30, 2016, compared to the same periods in 2015 due to lower gains from the sale of used

equipment that offset miscellaneous operating expenses. Gains from the sale of used equipment decreased to \$1.6 million for the three months ended September 30, 2016, from \$2.3 million for the same three months in 2015, and decreased to \$7.5 million for the nine months ended September 30, 2016, from \$12.2 million for the same nine months in 2015. The used equipment market continues to be weak but if it begins to tighten in the coming quarters, it will help offset other miscellaneous operating expenses.

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As a result of the above factors, our GAAP operating ratio (operating expenses expressed as a percentage of total revenue) increased to 86.8% for the third quarter of 2016, compared to 84.5% for the same quarter in 2015, and increased to 86.3% for the nine months ended September 30, 2016 from 84.9% for the same nine months in 2015. Our non-GAAP operating ratio based upon total operating expenses, net of fuel surcharge, as a percentage of total revenue, before fuel surcharge, was 85.6% for the third quarter of 2016, compared to 82.8% for the same quarter of 2015, and 85.1% for the nine months ended September 30, 2016, compared to 83.1% for the same nine months in 2015. Please see the reconciliation table above for a reconciliation of GAAP operating ratio to non-GAAP operating ratio. Excluding the \$7.2 million infrequent expense related to settlement costs for two class action lawsuits, our non-GAAP consolidated operating ratio was 82.2% for the nine months ended September 30, 2015.

While interest income remained constant as a percentage of total revenue in the three months and nine months ended September 30, 2016 and 2015, interest expense decreased in the third quarter ended September 30, 2016 as we continued to pay down borrowings on our line of credit. Our maximum borrowing limit under our revolving credit facility remains at \$300.0 million. Our debt balance decreased by \$60.0 million during the nine months ended September 30, 2016, to \$52.0 million from \$112.0 million at December 31, 2015.

As a percentage of total revenue, other income decreased to 0.5% for the three months ended September 30, 2016, from 0.8% for the same three months in 2015, and decreased to 0.6% for the nine months ended September 30, 2016, from 0.8% for the same nine months in 2015. These decreases were primarily due to investment activity and realized gains on sale of available-for-sale securities.

We provide for income taxes at the statutory federal and state rates, adjusted for certain permanent differences between financial statement income and income for tax reporting. Our effective tax rate was 38.4% for the three months ended September 30, 2016, and 37.2% for the same three months in 2015, while our effective tax rate was 39.6% for the nine months ended September 30, 2016, and 37.5% for the same nine months in 2015.

Due to the net result of the preceding financial results, our net income attributable to Knight Transportation decreased to 8.3% for the three months ended September 30, 2016, and decreased to 8.5% for the nine months ended September 30, 2015, compared to 10.1% and 9.8% in the same periods of 2015, respectively.

#### Liquidity and Capital Resources

The growth of our business has required, and will continue to require, significant investment in new revenue equipment. In our Trucking business, where investments are substantial, the primary investments are in new tractors and trailers and to a lesser extent, in technology, service centers, and working capital. In our Logistics business, where investments are modest, the primary investments are in technology and working capital. Our primary sources of liquidity have been funds provided by operations, issuances of our common stock, and borrowings under our line of credit.

Net cash provided by operating activities was \$189.2 million for the nine months ended September 30, 2016, compared to \$156.6 million provided during the same period in 2015. The increase in the 2016 period is primarily due to changes in operating assets and liabilities, and deferred taxes, partially offset by decreased net income in the 2016 period as compared to the 2015 period.

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Net cash used in investing activities was \$88.7 million for the nine months ended September 30, 2016, compared to net cash used of \$97.9 million for the same period in 2015. Capital expenditures for the purchase of revenue equipment, office equipment, and land and leasehold improvements, net of equipment sales, was \$76.1 million for the nine months ended September 30, 2016, compared to \$108.9 million for the same period in 2015. Excluding acquisitions, we currently anticipate capital expenditures, net of trade-ins, of approximately \$10.0 million to \$25.0 million for the remainder of 2016. We expect to use our capital expenditure estimate primarily to acquire new revenue equipment for replacement purposes and not fleet growth.

Net cash used in financing activities was \$105.3 million for the nine months ended September 30, 2016, compared to \$63.1 million for the same period in 2015. Net cash payments towards line of credit borrowings were \$60.0 million for the nine months ended September 30, 2016, compared to \$14.4 million in the same period of 2015. We repurchased approximately 1.6 million shares of our common stock for \$39.9 million in the nine months ended September 30, 2016, compared to 1.6 million shares of our common stock for \$45.3 million in the same period of 2015. We also paid \$14.8 million for dividends in the nine months ended September 30, 2016, and \$15.0 million in the same period of 2015. Proceeds from exercises of stock options were \$9.3 million in the nine months ended September 30, 2016, compared to \$9.2 million in the same period of 2015. We currently expect to continue to pay quarterly cash dividends in the future. Future payment of cash dividends, and the amount of any such dividends, will depend upon our financial condition, results of operations, cash requirements, tax treatment, and certain corporate law requirements, as well as other factors deemed relevant by our Board of Directors.

We currently maintain a line of credit that permits revolving borrowings and letters of credit up to an aggregate of \$300.0 million. The aggregate amount outstanding under our line of credit was \$52.0 million as of September 30, 2016, compared to \$112.0 million as of December 31, 2015. Our borrowings under the line of credit are classified as a long-term liability in the accompanying condensed consolidated balance sheets. We also utilized a portion of our line of credit for letters of credit, which are issued to various regulatory authorities and insurance carriers in connection with our self-insurance programs. The issued but unused letters of credit totaled \$31.1 million as of September 30, 2016, and \$27.4 million as of December 31, 2015. Combining the amounts borrowed and letters of credit issued, we had \$216.9 million available at September 30, 2016, for future borrowing under our existing line of credit, compared to \$160.6 million as of December 31, 2015. Under our current line of credit agreement, we are obligated to comply with certain financial and other covenants and were in compliance with those covenants as of September 30, 2016, and December 31, 2015.

Effective August 8, 2016, we entered into a modification to our line of credit agreement that extends the maturity date to August 1, 2019, and amends our minimum tangible net worth covenant to \$500.0 million from \$400.0 million. The foregoing description of the modification is qualified in its entirety by reference to the full text of the modification, a copy of which is filed as an exhibit hereto.

As of September 30, 2016, our cash and cash equivalents totaled approximately \$3.9 million compared to \$8.7 million as of December 31, 2015. During the next twelve months and beyond, we believe that we will be able to finance our short-term needs for working capital and acquisitions of revenue equipment with cash, cash flows from operations, and financing available under our existing line of credit. We expect to have significant capital requirements over the long-term, which may require us to incur debt or seek additional equity capital. The availability of additional capital will depend upon prevailing market conditions, the market price of our common stock, our financial condition and results of operations, and several other factors over which we have limited control. Nevertheless, based on our recent operating results, current cash position, anticipated future cash flows, and sources of available financing, we do not expect that we will experience any significant liquidity constraints in the foreseeable future.

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### Off-Balance Sheet Transactions

Our liquidity is not materially affected by off-balance sheet transactions. Like many other transportation companies, we have periodically utilized operating leases to finance a portion of our revenue equipment requirements and terminal facilities requirements. We lease revenue equipment under non-cancellable operating leases, and we lease some of our service centers and temporary trailer storage under non-cancellable operating leases. Operating lease expense for such equipment, facilities and trailer storage is reflected in the "Miscellaneous operating expenses" line in the accompanying condensed consolidated statements of income, and totaled \$1.3 million and \$1.2 million for the three months ended September 30, 2016 and 2015, respectively, and \$3.7 million and \$3.6 million for the nine months ended September 30, 2016 and 2015, respectively.

### Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires that management make a number of assumptions and estimates that affect the reported amounts of assets, liabilities, revenue, and expenses in our condensed consolidated financial statements and accompanying notes. Management bases its estimates on historical experience and various other assumptions believed to be reasonable. Although these estimates are based on management's best knowledge of current events and actions that may impact us in the future, actual results may differ from these estimates and assumptions. Our critical accounting policies are those that affect, or could affect, our financial statements materially and involve a significant level of judgment by management. The accounting policies we deem most critical to us include revenue recognition, which we recognize when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is probable. These conditions are met upon delivery. Furthermore, in accordance with ASC 605-45, Revenue Recognition – Principal Agent Consideration, we account for revenue from our Trucking operations, our Logistics operations, and revenue on freight transported by independent contractors within our Trucking operations on a gross basis. We are the primary obligor in these arrangements, we have the ability to establish prices, we have discretion in selecting the independent contractor or other third party that will perform the service, we have the risk of loss in the event of cargo claims, and we bear the credit risk associated with customer payments. Accordingly, all such revenue billed to customers is classified as operating revenue and all corresponding payments to carriers for transportation services we arrange in connection with Brokerage and Intermodal activities, and to independent contractor providers of revenue equipment, are classified as purchased transportation expense in the accompanying condensed consolidated statements of income. Other accounting policies deemed critical include allowance for doubtful accounts, depreciation, claims accrual, accounting for income taxes, and share based payments. There have been no significant changes to our critical accounting policies and estimates during the nine months ended September 30, 2016, compared to those disclosed in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation," included in our 2015 Annual Report on Form 10-K.

### Seasonality

In the transportation industry, results of operations generally follow a seasonal pattern. Freight volumes in the first quarter are typically lower due to less consumer demand and customers reducing shipments following the holiday season. In the first quarter of 2016, freight demand showed typical seasonality and was softer than the prior year first quarter when an unusually strong freight market prevailed. Operating expenses generally increase during the first quarter, and the tractor productivity of our fleet, independent contractors, and third-party carriers decreases in the winter months because of decreased fuel efficiency, increased cold weather-related equipment maintenance and repairs, and increased insurance claims and costs attributed to higher accident frequency from harsh weather. During this period, the profitability of our Trucking operations is generally lower than during other parts of the year. In our Logistics operations, profitability may be lower due to shipping volumes or may improve if we are able to achieve higher gross margins due to the willingness of third-party capacity providers to accept lower rates from us.





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### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Information about market risks as of September 30, 2016, does not differ materially from that discussed under Item 7A in our Annual Report on Form 10-K for the year ended December 31, 2015.

### Item 4. Controls and Procedures

We have established disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) to ensure that material information relating to us, including our consolidated subsidiaries, is made known to the officers who certify our financial reports and to other members of senior management and the Board of Directors. Our management, with the participation of our principal executive officer and principal financial officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures. Based on this evaluation, as of the end of the period covered by this Quarterly Report on Form 10-Q, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures are effective to ensure that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized, and reported within the time periods specified in the SEC rules and forms, and (ii) accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2016, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. We base our internal control over financial reporting on the criteria set forth in the 2013 COSO Internal Control: Integrated Framework.

We have confidence in our disclosure controls and procedures and internal control over financial reporting. Nevertheless, our management, including our principal executive officer and principal financial officer, does not expect that our disclosure controls and procedures and internal control over financial reporting will prevent all errors, misstatements, or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings

We are a party to certain claims and pending litigation arising in the normal course of business. These proceedings primarily involve claims for personal injury or property damage incurred in the transportation of freight or for personnel matters, as well as certain class action litigation in which the plaintiffs allege claims for failure to provide meal and rest breaks, unpaid wages, unauthorized deductions, and other items. We maintain insurance to cover liabilities arising from the transportation of freight in amounts in excess of self-insurance retentions.

Based on our present knowledge of the facts, and in certain cases, advice of outside counsel, management believes the resolution of open claims and pending litigation, taking into account existing reserves and accrued liabilities recorded, is not likely to have a materially adverse effect on us.

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## Item 1A. Risk Factors

While we attempt to identify, manage, and mitigate risks and uncertainties associated with our business, some level of risk and uncertainty will always be present. Our Annual Report on Form 10-K for the year ended December 31, 2015, in the section entitled "Item 1A. Risk Factors," describes some of the risks and uncertainties associated with our business. These risks and uncertainties have the potential to materially affect our business, financial condition, results of operations, cash flows, projected results, and future prospects.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

| Period   | (a)<br>Total<br>Number of<br>Shares<br>Purchased | (b)<br>Average<br>Price<br>Paid<br>per<br>Share | (c)<br>Total<br>Number of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | (d)<br>Maximum<br>Number of<br>Shares that<br>May<br>Yet Be<br>Purchased<br>Under<br>the Publicly<br>Announced<br>Plans or<br>Programs |
|--|--|---|---|--|
| July 1-31, 2016                                |  |   |   |  |
| Common Stock Repurchase Program <sup>(1)</sup> | -  | -   | -   | 4,364,045  |
| Other Transactions <sup>(2)</sup>              | -  | -   | -   | -  |
| August 1-31, 2016                              |  |   |   |  |
| Common Stock Repurchase Program <sup>(1)</sup> | 77,044   | \$ 28.21  | 77,044  | 4,287,001  |
| Other Transactions <sup>(2)</sup>              | 2,728  | \$ 28.10  | -   | -  |
| September 1-30, 2016                           |  |   |   |  |
| Common Stock Repurchase Program <sup>(1)</sup> | 40,000   | \$ 28.33  | 40,000  | 4,247,001  |
| Other Transactions <sup>(2)</sup>              | -  | -   | -   | -  |
| Total  | 119,772  | \$ 28.25  | 117,044   | 4,247,001  |

In 2011, our Board of Directors unanimously authorized the repurchase of up to 10.0 million shares of our common stock. The repurchase authorization will remain in effect until the share limit is reached or the program is <sup>(1)</sup>terminated. See Note 13 to the Condensed Consolidated Unaudited Financial Statements in this Quarterly Report on Form 10-Q for additional information with respect to our share repurchases.

Other Transactions include restricted shares of our common stock withheld and used to offset tax withholding <sup>(2)</sup>obligations that occurred upon vesting and release of restricted shares. The withholding of shares was permitted under the applicable award agreement and was not part of any stock repurchase program.

## Item 3. Defaults Upon Senior Securities

Not Applicable

## Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

Not Applicable

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## Item 6. Exhibits

| <u>Exhibit<br/>No.</u> | <u>Description</u>   |
|------------------------|--|
| Exhibit<br>3           | Articles of Incorporation and Bylaws   |
| (3.1)                  | Second Amended and Restated Articles of Incorporation of the Company. (Incorporated by reference to Appendix A to the Company's Definitive Proxy Statement on Schedule 14A filed April 20, 2007.)                            |
| (3.2)                  | 2016 Amended and Restated Bylaws of the Company. (Incorporated by reference to Exhibit 3.2 to the Company's Report on Form 10-Q for the period ended June 30, 2016.)   |
| Exhibit<br>10          | Material Contracts   |
| (10.1)*                | Third Modification Agreement, between Knight Transportation, Inc. and Wells Fargo Bank, National Association, dated February 2, 2016.  |
| (10.2)*                | Fourth Modification Agreement, between Knight Transportation, Inc. and Wells Fargo Bank, National Association, dated August 8, 2016.   |
| Exhibit<br>31          | Section 302 Certifications   |
| (31.1)*                | Certification pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, by David A. Jackson, the Company's Chief Executive Officer (principal executive officer). |
| (31.2)*                | Certification pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, by Adam W. Miller, the Company's Chief Financial Officer (principal financial officer).   |
| Exhibit<br>32          | Section 906 Certifications   |
| (32.1)**               | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by David A. Jackson, the Company's Chief Executive Officer.  |
| (32.2)**               | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Adam W. Miller, the Company's Chief Financial Officer.  |
| Exhibit<br>101         | Interactive Data File  |
| (101.INS)              | XBRL Instance Document.  |
| (101.SCH)              | XBRL Taxonomy Extension Schema Document.   |
| (101.CAL)              | XBRL Taxonomy Extension Calculation Linkbase Document.   |
| (101.DEF)              | XBRL Taxonomy Extension Definition Linkbase Document.  |
| (101.LAB)              | XBRL Taxonomy Extension Label Linkbase Document.   |
| (101.PRE)              | XBRL Taxonomy Extension Presentation Linkbase Document.  |
|                        | *Filed herewith  |
|                        | **Furnished herewith   |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

KNIGHT TRANSPORTATION, INC.

Date: November 9, 2016 By: /s/ David A. Jackson

David A. Jackson

Chief Executive Officer and President, in his capacity  
as such and on behalf of the registrant

Date: November 9, 2016 By: /s/ Adam W. Miller

Adam W. Miller

Chief Financial Officer, in his capacity as such and on  
behalf of the registrant