KNIGHT TRANSPORTATION INC
Form 10-Q
November 09, 2011

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
x Yes o 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
x Yes o 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 definition of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

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

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

The number of shares outstanding of registrant's common stock, par value $0.01 per share, as of October 31, 2011, was 79,364,657 shares.

KNIGHT TRANSPORTATION, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES
Condensed Consolidated Unaudited Balance Sheets
as of September 30, 2011 and December 31, 2010
(in thousands)

	September 30, 2011	December 31, 2010
ASSETS		
Current Assets:		
Cash and cash equivalents	$10,034	$28,013
Short-term investments held for trading	-	24,379
Accounts receivable, net of allowance for doubtful accounts	99,285	78,479
Notes receivable, net of allowance for doubtful accounts	1,166	1,391
Related party notes and interest receivable	2,868	3,038
Prepaid expenses	13,478	8,514
Assets held for sale	14,886	4,132
Other current assets	10,118	4,717
Income tax receivable	-	6,914
Current deferred tax asset	3,208	5,671
Total current assets	155,043	165,248
Property and Equipment:		
Revenue equipment	623,752	584,237
Land and land improvements	35,852	31,906
Buildings and improvements	80,332	77,949
Furniture and fixtures	11,191	8,112
Shop and service equipment	7,437	6,511
Leasehold improvements	2,734	2,512
Gross Property and Equipment	761,298	711,227
Less: accumulated depreciation and amortization	(234,364)	(227,518)
Property and equipment, net	526,934	483,709
Notes receivable – long-term	4,257	4,246
Goodwill	10,300	10,313
Intangible assets, net	5	52
Other long-term assets and restricted cash	16,152	13,419
Total assets	$712,691	$676,987

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

KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES
Condensed Consolidated Unaudited Balance Sheets (continued)
as of September 30, 2011 and December 31, 2010
(in thousands, except share data)

	September 30, 2011	December 31, 2010
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 17,280	$ 7,571
Accrued payroll and purchased transportation	10,116	6,547
Accrued liabilities	15,693	11,075
Claims accrual – current portion	14,124	13,843
Dividend payable – current portion	74	1,433
Total current liabilities	57,287	40,469
Long-term Liabilities:		
Line of credit	50,000	-
Claims accrual – long-term portion	10,132	10,168
Dividend payable – long-term portion	1,401	-
Deferred tax liabilities	130,903	118,886
Total long-term liabilities	192,436	129,054
Total liabilities	249,723	169,523
Commitments and Contingencies		
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; 79,363 and 83,693 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively	794	837
Additional paid-in capital	131,685	126,975
Accumulated other comprehensive (loss) income	(308)	7
Retained earnings	330,642	379,714
Total Knight Transportation shareholders' equity	462,813	507,533
Noncontrolling interest	155	(69)
Total shareholders' equity	462,968	507,464
Total liabilities and shareholders' equity	$ 712,691	$ 676,987

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 September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
REVENUE:				
Revenue, before fuel surcharge	$183,436	$162,066	$516,285	$457,672
Fuel surcharge	43,707	29,233	125,814	84,726
Total revenue	227,143	191,299	642,099	542,398
OPERATING EXPENSES:				
Salaries, wages and benefits	55,428	53,468	162,219	153,632
Fuel expense	59,726	44,585	169,503	128,795
Operations and maintenance	13,725	12,091	40,312	34,693
Insurance and claims	8,012	6,100	23,027	18,441
Operating taxes and licenses	3,634	3,596	11,239	10,214
Communications	1,376	1,341	4,097	4,054
Depreciation and amortization	19,115	16,955	55,941	52,885
Purchased transportation	35,304	23,099	95,544	58,903
Miscellaneous operating expenses	3,118	2,880	9,430	9,022
Total operating expenses	199,438	164,115	571,312	470,639
Income from operations	27,705	27,184	70,787	71,759
Interest income	130	487	937	1,426
Interest expense	(49)	-	(49)	-
Other (expense) income	(1)	(91)	7	571
Income before income taxes	27,785	27,580	71,682	73,756
Income taxes	11,115	10,965	28,680	28,990
Net income	16,670	16,615	43,002	44,766
Net (income)/loss attributable to noncontrolling interest	(107)	36	(224)	64
Net income attributable to Knight Transportation	$16,563	$16,651	$42,778	$44,830
Earnings per common share and common share equivalent:				
Basic	$0.21	$0.20	$0.52	$0.54
Diluted	$0.21	$0.20	$0.52	$0.53
Weighted average number of common shares and common share equivalents outstanding:				
Basic	79,895	83,590	82,136	83,482
Diluted	80,212	84,403	82,621	84,317

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 September 30, 2011	Nine Months Ended September 30, 2010
Cash Flows From Operating Activities:		
Net income	$43,002	$44,766
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	55,941	52,885
Gain on sale of equipment	(4,385)	(3,372)
Earnout on sold investment	-	(718)
Gain from insurance claim settlement	-	(100)
Gain from TRP I earnout	(13)	-
Loss from investment in Transportation Resource Partners III	6	236
Non-cash compensation expense for issuance of stock to certain members of board of directors	112	112
Provision for doubtful accounts and notes receivable	555	1,304
Excess tax benefits related to stock-based compensation	(127)	(373)
Stock-based compensation expense	2,818	3,152
Deferred income taxes	14,685	(561)
Changes in operating assets and liabilities:		
Short-term investments held for trading	24,379	(3,448)
Accounts receivable	(20,787)	(10,857)
Related party interest receivable	(49)	88
Other current assets	(5,401)	(879)
Prepaid expenses	(4,965)	(5,002)
Income tax receivable	6,914	(4,189)
Other long-term assets	(8)	(104)
Accounts payable	1,578	2,904
Accrued liabilities and claims accrual	8,101	2,287
Net cash provided by operating activities	122,356	78,131
Cash Flow Used in Investing Activities:		
Purchase of property and equipment	(119,068)	(114,735)
Proceeds from sales of equipment	21,087	27,616
Proceeds from insurance claim settlement	-	100
Cash collection from notes receivable	2,203	2,315
Cash issued for notes receivable	(1,939)	(1,240)
Cash proceeds from related party notes receivable	219	445
Increase in restricted cash	(659)	(69)
Purchase of long-term available for sale securities	(263)	(1,879)
Cash received from Concentrek earnout	-	718
Cash received from TRP I earnout	13	-
Investments in Transportation Resource Partners I & III	(2,315)	(2,571)
Return of investment in Transportation Resource Partners	-	110

Net cash used in investing activities	(100,722)	(89,190)

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

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

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Cash Flow Used in Financing Activities:		
Dividends paid	$(14,777)	$(14,196)
Payments to repurchase company stock	(76,564)	-
Proceeds from borrowing on line of credit	50,000	-
Excess tax benefits related to stock-based compensation	127	373
Cash investment from noncontrolling interest holder	-	24
Proceeds from exercise of stock options	1,601	3,711
Net cash used in financing activities	(39,613)	(10,088)
Net decrease in cash and cash equivalents	(17,979)	(21,147)
Cash and cash equivalents, beginning of period	28,013	30,812
Cash and cash equivalents, end of period	$10,034	$9,665
Supplemental Disclosures:		
Non-cash investing and financing transactions:		
Equipment acquired with accounts payable	$8,267	$312
Transfer from property and equipment to assets held for sale	$20,419	$15,300
Financing provided to independent contractors for equipment sold	$2,148	$2,984
Dividend accrued for restricted stock units	$156	$234
Cash Flow Information:		
Income taxes paid	$6,420	$35,849
Interest paid	$23	-

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, 2010.

Note 2. Stock-Based Compensation

We have one stock-based employee compensation plan known as the Knight Transportation, Inc. Amended and Restated 2003 Stock Option and Equity Compensation Plan, as amended and restated in May 2009 (the "2003 Plan"). Stock based compensation cost for the three months and nine months ended September 30, 2011 and 2010, respectively, are as follows:

	Three Months Ended September 30, (in thousands)		Nine Months Ended September 30, (in thousands)	
	2011	2010	2011	2010
Stock compensation expense for options, net of forfeitures	$419	$851	$1,734	$2,514
Stock compensation expense for restricted stock units, net of forfeitures	341	214	1,084	638
Combined stock compensation expense	760	1,065	2,818	3,152
Income tax	(305)	(423)	(1,128)	(1,236)
Net stock compensation expense after tax	$455	$642	$1,690	$1,916

We received approximately $0.4 million and $1.6 million in cash from the exercise of stock options during the three months and nine months ended September 30, 2011, compared to $0.7 million and $3.7 million for the same periods in 2010.

As of September 30, 2011, we have approximately $5.7 million of unrecognized compensation cost related to unvested options granted under the 2003 Plan. This cost is expected to be recognized over a weighted-average period of 2.2 years and a total period of 6.2 years. We also have approximately $17.2 million of unrecognized compensation expense related to restricted stock unit awards, which is anticipated to be recognized over a weighted average period of 6.0 years and a total period of 11.3 years.

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The fair value of each option grant is estimated on the date of grant using the Black-Scholes option valuation model that uses the following assumptions:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2011		2010		2011		2010	
Dividend yield (1)	1.58	%	1.21	%	1.58	%	1.21	%
Expected volatility (2)	33.73	%	34.61	%	33.73	%	34.61	%
Risk-free interest rate (3)	0.38	%	2.10	%	0.38	%	2.10	%
Expected term (4)	3.92 years		4.92 years		3.92 years		4.92 years	
Weighted average fair value of options granted	$3.48		$5.58		$3.48		$5.58	

(1) Dividend yield – the dividend yield is based on our historical experience and future expectation of dividend payouts.
(2) Expected volatility – we analyzed the volatility of our stock using historical data for the past 7 years through the end of the most recent period to estimate the expected volatility.
(3) 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.
(4) Expected term – the expected term of employee stock options represents the weighted-average period the stock options are expected to remain outstanding and has been determined based on an analysis of historical exercise behavior for the past 7 years through the end of the most recent period.

A summary of the option award activity under the 2003 Plan as of September 30, 2011, and changes during the nine-month period is presented below:

	Option Totals		Weighted Average Exercise Price Per Share
Outstanding as of December 31, 2010	4,144,476	$	15.68
Granted	109,500		15.15
Exercised	(160,608)		9.87
Forfeited	(153,846)		16.83
Outstanding as of September 30, 2011	3,939,522	$	15.82

A summary of the restricted stock unit award activity under the 2003 Plan as of September 30, 2011, and changes during the nine-month period is presented below:

	Number of Restricted Stock Unit Awards		Weighted Average Grant Date Fair Value
Unvested as of December 31, 2010	1,364,560	$	16.11
Granted	48,500		15.15
Vested	(81,513)		16.11
Forfeited	(64,280)		16.09
Outstanding as of September 30, 2011	1,267,267	$	16.08

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

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Note 3. Earnings Per Share

A reconciliation of the basic and diluted earnings per share computations for the three and nine months ended September 30, 2011 and 2010, respectively, is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(in thousands, except per share data)			
Weighted average common shares outstanding – basic	79,895	83,590	82,136	83,482
Dilutive effect of stock options and unvested restricted stock units	317	813	485	835
Weighted average common shares outstanding – diluted	80,212	84,403	82,621	84,317
Net income attributable to Knight Transportation	$16,563	$16,651	$42,778	$44,830
Earnings per common share:				
Basic	$0.21	$0.20	$0.52	$0.54
Diluted	$0.21	$0.20	$0.52	$0.53

Certain shares of common stock were excluded from the computation of diluted earnings per share because the related options' exercise prices were greater than the average market price of the common shares, and therefore, the effect would be anti-dilutive. A summary of those options are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Number of anti-dilutive shares	3,508,461	87,000	2,653,243	34,291

Note 4. Segment Information

We are a provider of multiple truckload transportation services with a nationwide network of service centers through which we operate one of the country's largest tractor fleets. In addition to our own fleet, we also partner with third-party equipment providers to provide truckload capacity and a broad range of solutions to truckload shippers. We have five operating segments comprised of three asset-based operating segments (dry van truckload, temperature-controlled truckload, and port services) and two non-asset-based operating segments (brokerage and intermodal services). Through our asset-based and non-asset-based 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 the past, we identified two reportable segments comprised of an asset-based segment and a non-asset-based segment. As we broaden the range of our truckload solutions for our customers across multiple service offerings and transportation modes, we assess the impact of these changes on our determination of operating and reportable segments. Based on the guidance set forth in Accounting Standards Codification ("ASC") Sub-Topic 280-10, Segment Reporting, we have determined we have one reportable segment. All five operating segments meet all of the aggregation criteria set forth in the guidance. Based on our evaluation, we also concluded that all operating segments exhibit similar long-term economic characteristics, have similar performance indicators, and are exposed to the same competitive, operating, financial, and other risk factors.

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Note 5. Joint Venture

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, the financial activities of this entity are consolidated into our 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 or property damage incurred in the transportation of freight or for personnel matters. We maintain insurance to cover liabilities arising from the transportation of freight in amounts in excess of self-insurance retentions. Our self-insurance retention for auto liability ranges from $1.0 million to $2.0 million per occurrence depending on the applicable policy year. Our self-insurance retention for workers' compensation claims is $500,000 per occurrence. Based on our present knowledge of the facts and, in certain cases, advice of outside counsel, management does not believe the resolution of claims and pending litigation, taking into account existing accrued amounts, is likely to have a materially adverse effect on us.

We also are involved in 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. Based on our knowledge of the facts and advice of outside counsel, management does not believe the outcome of this litigation is likely to have a materially adverse effect on us. However, the final disposition of these matters and the impact of such final dispositions cannot be determined at this time.

Note 7. Dividends

On August 11, 2011, we declared a cash dividend of $0.06 per share of our common stock. The dividend was payable to shareholders of record on September 2, 2011, and was paid on September 30, 2011. 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.

Note 8. Goodwill and Intangible Assets

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 amount of goodwill and intangible assets for the nine months ended September 30, 2011, are as follows:

Goodwill:	In Thousands
Balance at December 31, 2010	$ 10,313
Amortization relating to deferred tax assets	(13)
Balance at September 30, 2011	$ 10,300

Intangible Assets:	In Thousands
Balance at December 31, 2010	$ 52
Amortization	(47)

Balance at September 30, 2011	$ 5

Intangible assets are being amortized on a straight-line basis over a five-year period. Annual amortization expense is expected to be $52,000 for fiscal year 2011.

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Note 9. Investments and Related Commitments

In 2003, we signed a partnership agreement with Transportation Resource Partners, LP ("TRP"), who makes privately negotiated equity investments. Our investment in TRP is accounted for using the cost method, as our level of influence over the operations of TRP is minor. At September 30, 2011, the carrying book balance of our investment in TRP was $2.2 million, and our ownership interest was approximately 2.0%. This balance is included in "Other long-term assets and restricted cash" of our consolidated balance sheet.

In the fourth quarter of 2009, we committed to invest $15.0 million in a new partnership managed and operated by the managers and principals of TRP. The new partnership, Transportation Resource Partners III, LP ("TRP III"), is focused on the same investment opportunities as TRP. Since its inception, we have contributed approximately $5.2 million to TRP III, leaving an outstanding commitment of $9.8 million as of September 30, 2011. In accordance with Accounting Standards Codification Topic 323, our investment in TRP III is accounted for using the equity method. At September 30, 2011, our investment balance in TRP III was $4.8 million, and our ownership interest was approximately 6.1%. This balance is included in “Other long-term assets and restricted cash" of our consolidated balance sheet.

Note 10. Marketable Equity Securities

We have certain marketable equity securities that are classified as available-for-sale securities, which are recorded at fair value with unrealized gains and losses as a component of accumulated other comprehensive income in shareholders’ equity. Realized gains and losses on available-for-sale securities are included in the determination of net income. As of September 30, 2011, our available-for-sale equity investment included in “Other long-term assets and restricted cash" was approximately $4.7 million, including unrealized loss of approximately $510,000.

Note 11. Comprehensive Income

The components of comprehensive income for the periods noted were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(in thousands)			
Net income attributable to Knight Transportation	$16,563	$16,651	$42,778	$44,830
Other comprehensive income:				
Net unrealized gain/(loss) from available-for-sale securities	53	202	(315)	202
Total comprehensive income	$16,616	$16,853	$42,463	$45,032

Note 12. 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 consolidated balance sheet. Assets held for sale at September 30, 2011, totaled $14.9 million, compared to $4.1 million at December 31, 2010. 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.

Note 13. 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 statements and tax basis 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. 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 history of 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 U.S. and state income tax returns with varying statutes of limitations. The 2007 through 2010 tax years generally remain subject to examination by federal authority, and the 2006 through 2010 tax years generally remain subject to examination by state tax authorities. We believe that our income tax filing positions and deductions will be sustained on 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. We have not recorded any unrecognized tax benefits at September 30, 2011.

Note 14. Company Share Repurchase Programs

On May 19, 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 us the 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.

Under our share repurchase program, we repurchased 1,147,400 shares of our common stock in the open market for approximately $17.4 million in the third quarter of 2011. During the nine-month period ended September 30, 2011, we repurchased 4,582,400 shares of our common stock in the open market for approximately $76.6 million. The shares acquired have been retired and are available for future issuance. The purchases were made in accordance with Securities and Exchange Commission Rule 10b-18, which limits the amount and timing of repurchases. As of September 30, 2011, there were 7,438,556 shares remaining for future purchases under our current repurchase program. The repurchase authorization will remain in effect until the share limit is reached or the program is terminated.

Note 15. Fair Value Measurements

Our assets and liabilities that have been 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. Our financial assets and liabilities also include accounts receivable, accounts payable, and accrued liabilities. Due to the short-term nature of these instruments, their fair value approximates their carrying value on the balance sheet. This standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, 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 the Company 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 the Company has 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.

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 the Company's 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 the Company's financial assets and liabilities that are required to be measured at fair value as of September 30, 2011 and December 31, 2010.

			Level One		Level Two		Level Three	
	Balance at September 30, 2011	Balance at December 31, 2010	Balance at September 30, 2011	Balance at December 31, 2010	Balance at September 30, 2011	Balance at December 31, 2010	Balance at September 30, 2011	Balance at December 31, 2010
	(in thousands)							
Assets:								
Money market funds	-	$ 22,856	-	$ 22,856	-	-	-	-
Trading Securities:								
Debt securities -municipal securities	-	$ 24,379	-	-	-	$ 24,379	-	-
Available-for-sale Securities:								
Equity securities -common shares	$ 4,664	$ 4,923	$ 4,664	$ 4,923	-	-	-	-
Restricted cash and investments:								
Money market funds and debt securities –municipal securities	$ 3,538	$ 2,879	$ 832	$ 811	$ 2,706	$ 2,068	-	-

Note 16. 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, including principal and interest payments generally ranging from 5% to 14%, over periods generally ranging from six months to four years. We had 208 and 210 loans outstanding from independent contractors and third parties as of September 30, 2011 and December 31, 2010, respectively.

The notes receivable balances are classified separately between current and long-term in the balance sheet. The current and long-term balance of our notes receivable at September 30, 2011 and December 31, 2010 are as follows:

	September 30, 2011	December 31, 2010
	(in thousands)	
Notes receivable from independent contractors	$ 1,551	$ 2,391
Notes receivable from third parties	4,228	3,598
Net investment in sales-type leases	73	128
Gross notes receivable	5,852	6,117
Allowance for doubtful notes receivable	(429)	(480)
Total notes receivable net of allowance	5,423	5,637
Current portion (net of allowance)	1,166	1,391
Long-term portion	$ 4,257	$ 4,246

The following lists the components of the net investment in sales-type leases as of September 30, 2011 and December 31, 2010:

	September 30, 2011	December 31, 2010
	(in thousands)	
Total minimum lease payments to be received	$ 78	$ 140
Less: unearned income	(5)	(12)
Net investment in sales-type leases	$ 73	$ 128

The current and long-term portions of the Company's net investment in sales-type leases are included in notes receivable in the accompanying consolidated balance sheets. The interest method is used to amortize unearned income, which amortizes unearned income to income over the lease term so as to produce a constant periodic rate of return on the net investment in each lease. The amortization of unearned income is included in interest income and other in the accompanying consolidated statements of operations.

Note 17. Related Party Transactions

We have provided general business loans to US West Agriculture Exporters, LLC, a company that transacts business with our drayage operation, and in which Larry Knight is a 33% owner. Larry Knight is an employee of the Company and the brother of Kevin Knight and Keith Knight, our Chief Executive Officer and Chief Operating Officer, respectively. The loan balance, including interest, due at September 30, 2011, was approximately $2.9 million, compared to approximately $3.0 million at December 31, 2010. The principal loan and interest balance is recorded in the "Related party notes and interest receivable" line of our consolidated balance sheets. We also provided transportation services to US West Agriculture Exporters, LLC through December 31, 2010. Transportation services provided to US West Agriculture Exporters have been paid in full. US West Agriculture Exporters, LLC discontinued operations as of December 31, 2010. The loan to US West Agriculture Exporters, LLC is secured by guaranties of the members of US West Agriculture Exporters, LLC. We are currently working with US West Agriculture Exporters, LLC regarding the repayment of the outstanding balance of the loan and have received a court judgment protecting our rights in the assets of US West Agriculture Exporters, LLC. Based on its knowledge of the facts, management believes it will recover the entire outstanding principal balance of the loan.

Note 18. Line of Credit

In the third quarter of 2011, we amended our line of credit agreement with Wells Fargo Bank to extend the maturity date from September 2012 to July 2016, and to increase the line of credit from $50.0 million $150.0 million. The amended line of credit bears interest either at the prime rate or LIBOR plus 0.625%, determined by us at the time of borrowing. In the third quarter of 2011, we borrowed $50.0 million from the line of credit bearing interest rate of LIBOR plus 0.625%, resulting in a weighted average variable annual percentage rate (APR) of 0.84% for the quarter. Borrowing under our line of credit is recorded in the "Line of credit" line of our consolidated balance sheets. Our total debt balance was $50.0 million as of September 30, 2011. We also have utilized $25.2 million of our line of credit for letters of credit issued to various regulatory authorities in connection with our self-insurance programs. As of September 30, 2011, the line of credit available for future borrowing was $74.8 million. We are obligated to comply with certain financial and other covenants under our line of credit agreement, including maintaining a ratio of consolidated debt to consolidated EBITDA of not greater than 2.0 to 1.0, maintaining positive pre-tax profit for each fiscal quarter, maintaining positive net income after tax for each fiscal year, and maintaining tangible net worth of not less than $325.0 million. We were in compliance with the covenants at September 30, 2011 and December 31, 2010.

Subsequent to the quarter ended September 30, 2011, we borrowed another $5.0 million under the line of credit bringing our total debt balance to $55.0 million as of the date of this filing.

Note 19. Recent Accounting Pronouncements

In September 2011, the FASB issued ASU No. 2011-08, "Intangibles-Goodwill and Other (ASC Topic 350): Testing Goodwill for Impairment" ("ASU 2011-08"), which amends current goodwill impairment guidance. Under the amendments in this ASU, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, then the entity is required to perform the second step of the goodwill impairment test to measure the amount of the impairment loss, if any. Under the amendments in this ASU, an entity also has the option to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the first step of the two-step goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period. The amendments are effective for annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. Adoption of ASU 2011-08 is not expected to have a material impact on the Company's consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, "Comprehensive Income (ASC Topic 220): Presentation of Comprehensive Income" ("ASU 2011-05"), which amends current comprehensive income guidance. This accounting update eliminates the option to present the components of other comprehensive income as part of the statement of shareholders' equity. Instead, the Company must report comprehensive income in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. ASU 2011-05 will be effective during the interim and annual periods beginning after December 15, 2011. Early adoption is permitted. Adoption of ASU 2011-05 is not expected to have a material impact on the Company's consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, "Fair Value Measurement (ASC Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs" ("ASU 2011-04"), which clarifies existing fair value measurement and disclosure requirements, amends certain fair value measurement principles, and requires additional disclosures about fair value measurements. ASU 2011-04 will be effective during the interim and annual periods beginning after December 15, 2011. Early adoption is not permitted. Adoption of ASU 2011-04 is not expected to have a material impact on the Company's consolidated financial statements.

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

Cautionary Note Regarding Forward-Looking Statements

Except for certain historical information contained herein, this 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. All statements, other than statements of historical fact, are statements that could be deemed forward-looking statements, including without limitation: any projections of revenues, earnings, cash flows, 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. Words such as "believe," "may," "could," "expects," "hopes," "estimates," "projects," "intends," "anticipates," and "likely," and variations of these words, or similar expressions, terms, or phrases, are intended to identify such forward-looking statements. Forward-looking statements are inherently subject to risks, assumptions, 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, 2010, along with any supplements in Part II below.

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. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Company's expectations with regard thereto or any change in the events, conditions, or circumstances on which any such statement is based.

Introduction

Business Overview

We are a provider of multiple truckload transportation services, which generally involve the movement of full trailer or container loads of freight from origin to destination for a single customer. We use our nationwide network of service centers, one of the country's largest company-owned tractor fleets, as well as access to the fleets of thousands of third-party equipment providers, to provide significant capacity and a broad range of solutions to truckload shippers. Our services include dry van truckload, temperature-controlled truckload, and dedicated truckload services, drayage services between ocean ports or rail ramps and shipping docks, rail intermodal services, and truckload freight brokerage services. Through our asset-based and non-asset-based operations, we are able to transport, or arrange for the transportation of, general commodities for customers throughout the United States and parts of Canada and Mexico.

Our operating strategy for our asset-based operations 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 decentralized service centers enable us to better serve our customers and work more closely with our driving associates. We operate a modern fleet to appeal to drivers and customers, decrease maintenance expenses and downtime, and enhance our operating efficiencies. We employ technology in a cost-effective manner to assist us in controlling operating costs and enhancing revenue. Our operating strategy for our non-asset-based operations is to match the shipping needs of our customers, that do not fit our asset-based services, with the capacity provided by our network of third-party truckload carriers and our rail partners.

Our goal is to increase our market presence, both in existing operating regions and in other areas where we believe the freight environment meets our operating strategy, while seeking to achieve industry-leading operating margins and returns on investment.

Over the past seven years, we have implemented our strategy of providing truckload shippers with a diversified range of truckload service offerings, including expanding our operations to include temperature-controlled truckload, brokerage, and port and rail drayage services. Most recently in 2010, we advanced our objective to grow services with the addition of our rail intermodal services offered through our Knight Intermodal operation. We believe that this strategic diversified customer offering positions us for growth with existing and new truckload shipping customers. As part of our growth strategy, we also evaluate acquisition opportunities that meet our financial and operating criteria.

The main factors that affect our results are 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), the freight volumes brokered to third-party equipment providers, and our ability to control our costs.

Outlook

We continued to grow our revenue and expand our customer base in the third quarter of 2011. This yielded positive results for the period as we experienced strength in many of the truckload markets we serve. We increased our revenue before fuel surcharge by 13.2% and improved our revenue per tractor excluding fuel surcharge by 4.6% as compared to the third quarter of last year. As many truckload shippers are managing very thin inventories with their just-in-time supply chains, our expertise with short-to-medium length of haul freight and our network of service centers enable us to gain additional market share in this competitive industry.

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We are committed to providing our customers a broad and growing range of truckload services and continue to invest considerable resources toward developing a range of solutions for truckload customers across multiple service offerings and transportation modes. Our objective is to be an industry leader in growth and profitability for each service and mode of truckload transportation we provide. In our asset-based operations, we achieve this by operating with a low cost per mile while providing a premium level of service. In our non-asset-based operations, our strategy is to leverage our existing network, customer relationships, and market teams to provide alternatives at a lower cost per transaction than our competitors.

Going forward, we expect generally favorable truckload freight trends to continue through the remainder of the year and believe industry capacity will remain tight, as barriers to effective competition in our markets continue to grow with the rise in commodity and equipment prices, the growing complexity of technology, increased regulation, and the difficulties in obtaining financing. We believe that we are well positioned to capitalize on strategic opportunities to grow each of our businesses.

Revenue and Expenses

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

The most significant expenses in our business include fuel, driver-related expenses (such as wages, benefits, training, and recruitment), and independent contractor (owner-operator) and third-party carrier payments, including payments to our rail providers (which are recorded on the "Purchased transportation" line of our consolidated statements of income). Expenses that have both fixed and variable components include maintenance and tire expense and our total cost of insurance and claims. These expenses generally vary with the miles we travel, but also have a controllable component based on safety, fleet age, efficiency, and other factors. Our main fixed costs are depreciation of long-term assets, such as revenue equipment and service centers, and the compensation of non-driver personnel. Effectively controlling our expenses is an important element of assuring our profitability. The primary measure we use to evaluate our profitability is operating ratio, excluding the impact of fuel surcharge revenue (operating expenses, net of fuel surcharge, as a percentage of revenue, before fuel surcharge).

Since our inception, an important element of our operating model has been an extreme focus on our cost per mile. We intend to carry this focus with us as we expand service offerings, grow existing service centers, and make selective acquisitions.

Recent Results of Operations and Quarter-End Financial Condition

Our results of operations for the quarter ended September 30, 2011, in comparison to the same period in 2010 are:

Revenue, before fuel surcharge, increased 13.2%, to $183.4 million from $162.1 million;

Net income attributable to Knight was approximately the same at $16.6 million, compared to $16.7 million a year ago; and

Net income per diluted share increased 4.7%, to $0.21 per share from $0.20 per share.

In the third quarter of 2011, average revenue per tractor improved 4.6% while average fleet count increased 1.8% when compared to the same period of 2010. The revenue per tractor improvement was driven by a 2.2% increase in revenue per total mile and a 2.3% increase in miles per tractor. We realized improvements in revenue per loaded mile, which improved 1.9%, and non-paid empty miles, which improved 2.7%, in the current quarter compared to the same quarter of 2010. Higher fuel prices continued to negatively affect operating results as the U.S. National Average Diesel Fuel price per gallon increased 31.5% in the third quarter of 2011 compared to the same period of 2010.

We ended the quarter with 3,939 tractors at September 30, 2011, compared to 3,912 tractors a year ago. Tractors operated by independent contractors increased 6.6%, from 426 tractors to 454 tractors in the third quarter of this year. At September 30, 2011, tractors operated by independent contractors represented 11.5% of our total fleet, compared to 10.9% a year ago.

Our consolidated operating ratio (operating expenses, net of fuel surcharge, expressed as a percentage of revenue, before fuel surcharge), which is a non-GAAP measurement, was 84.9% for the quarter ended September 30, 2011, compared to 83.2% for the same period a year ago.

Our capital expenditures, net of equipment sales, were $98.0 million for the nine months ended September 30, 2011. At September 30, 2011, our cash and cash equivalents totaled $10.0 million, and our shareholders' equity was $463.0 million.

Results of Operations

The following table sets forth the percentage relationships of our expense items to total revenue, including fuel surcharge (Columns A and C), and revenue, before fuel surcharge (Columns B and D), for the three-month and nine-month periods ended September 30, 2011 and 2010, respectively. Fuel expense as a percentage of revenue, before fuel surcharge, is calculated using fuel expense, net of fuel surcharge. We believe that eliminating the impact of this sometimes volatile source of revenue affords a more consistent basis for comparing our results of operations from period to period.

We also discuss the changes in our expenses as a percentage of revenue, before fuel surcharge, rather than absolute dollar changes. We do this because we believe the high variable cost nature of our business makes a comparison of changes in expenses as a percentage of revenue, before fuel surcharge, more meaningful than absolute dollar changes.

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	(A) (Fuel surcharge included in revenue) Three-Month Period Ended September 30,		(B) (Fuel surcharge excluded from revenue and netted to fuel expense) Three-Month Period Ended September 30,		(C) (Fuel surcharge included in revenue) Nine-Month Period Ended September 30,		(D) (Fuel surcharge excluded from revenue and netted to fuel expense) Nine-Month Period Ended September 30,	
	2011	2010	2011	2010	2011	2010	2011	2010
Revenue	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %
Operating expenses: *								
Salaries, wages and benefits	24.4	27.9	30.2	33.0	25.3	28.3	31.4	33.6
Fuel	26.3	23.3	8.7	9.5	26.4	23.7	8.5	9.6
Operations and maintenance	6.0	6.3	7.5	7.5	6.3	6.4	7.8	7.6
Insurance and claims	3.5	3.2	4.4	3.8	3.6	3.4	4.5	4.0
Operating taxes and licenses	1.6	1.9	2.0	2.2	1.8	1.9	2.2	2.2
Communications	0.6	0.7	0.8	0.8	0.5	0.7	0.8	0.9
Depreciation and amortization	8.5	8.9	10.4	10.4	8.7	9.8	10.8	11.5
Purchased transportation	15.5	12.1	19.2	14.2	14.9	10.9	18.5	12.9
Miscellaneous operating expenses	1.4	1.5	1.7	1.8	1.5	1.7	1.8	2.0
Total operating expenses	87.8	85.8	84.9	83.2	89.0	86.8	86.3	84.3
Income from operations	12.2	14.2	15.1	16.8	11.0	13.2	13.7	15.7
Interest income	0.0	0.2	0.1	0.4	0.2	0.3	0.2	0.3
Interest expense	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other income (expense)	0.0	0.0	0.0	(0.1)	0.0	0.1	0.0	0.1
Income before income taxes	12.2	14.4	15.2	17.1	11.2	13.6	13.9	16.1
Income taxes	4.9	5.7	6.1	6.8	4.5	5.3	5.6	6.3
Net income	7.3	8.7	9.1	10.3	6.7	8.3	8.3	9.8
Net gain/(loss) attributable to noncontrolling interest	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Net income attributable to Knight Transportation								